The Institute of Chartered Accountants in England and Wales

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Workbook

For exams in 2021

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Financial Management

The Institute of Chartered Accountants in England and Wales

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Contents

Questions within the Workbook should be treated as preparation questions, providing you with a firm foundation before you attempt the exam-standard questions. The exam-standard questions are found in the Question Bank.

Welcome to ICAEW

I'd like to personally welcome you to ICAEW.

In a fast-changing and volatile world, the role of the accountancy profession has never been more important.

As an ICAEW Chartered Accountant, you will make decisions that will define the future of global business.

By choosing our world-leading chartered accountancy qualification, the ACA, you will acquire exceptional knowledge and skills – with technology and ethics at the heart of your learning. A focus on capabilities such as judgement and scepticism will enable you to make the right decisions in diverse and often complex environments.

You will be equipped to flourish and to lead in areas that are transforming the business landscape. This includes embracing technological change and harnessing digital disruption, to help our profession deliver greater value. It also includes putting climate change and sustainability at the heart of business strategy. We will equip you to be adaptable and agile in your work and all within a set of values fundamental to trust and transparency, which will set you apart from others.

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ICAEW will support you through your studies and throughout your career: this is the start of a lifetime relationship, and we will be with you every step of the way to ensure you are ready to face the challenges of the global economy. Visit page v to review the key resources available as you study.

With our training, guidance and support, you will join our members in realising your career ambitions, developing world-leading insights and maintaining a competitive edge.

We will create a world of strong economies, together.

I wish you the best of luck with your studies.

Michael Izza

Chief Executive

ICAEW

Financial Management

If you are studying this exam as part of the ACA qualification go to icaew.com/examresources or if you are studying the ICAEW CFAB qualification go to icaew.com/cfabstudents.

Module aim

Financial Management enables students to recommend relevant options for financing a business, recognise and manage financial risks and make appropriate investment decisions.

On completion of this module, students will be able to:

- identify capital requirements of businesses, assess financing options and recommend relevant methods of financing;
- identify the financial risks facing a business and the principal methods of managing those risks; and
- apply appropriate investment appraisal techniques taking into account other factors affecting investment decisions.

Method of assessment

The Financial Management module exam is 2.5 hours long. The exam consists of three questions. Managing financial risk will be assessed as a discrete topic. The other two questions will assess financing options and investment decisions and valuation either as discrete or integrated topics.

Specification grid

This grid shows the relative weightings of subjects within this module and should guide the relative study time spent on each. Over time the marks available in the assessment will equate to the weightings below, while slight variations may occur in individual assessments to enable suitably rigorous questions to be set.

	Weighting (%)
1 Financing options	35
2 Managing financial risk	30
3 Investment decisions and valuation	35

Permitted texts

At the Professional and Advanced Levels there are specific texts that you are permitted to use during your exam. All information for these texts is available on icaew.com/permittedtexts.

Professional level exams	**Permitted text**
Audit and Assurance	✔
Financial Accounting and Reporting	✔
Tax Compliance	✔
Business Strategy and Technology	x
Financial Management	x
Business Planning	No restrictions

Advanced Level exams	
Corporate Reporting	No restrictions
Strategic Business Management	No restrictions
Case Study	No restrictions

The exams which have no restrictions include the following:

- Business Planning: Banking;
- Business Planning: Insurance;
- Business Planning: Taxation;
- Corporate Reporting;
- Strategic Business Management; and
- Case Study.

This information, as well as what to expect and what is and is not permitted in each exam is available in the Instructions to Candidates. You will be sent the instructions with your exam admission details. They can also be viewed on our website at icaew.com/exams.

Key resources

Whether you're studying the ACA qualification with an employer, at university, independently (self-studying), or as part of an apprenticeship, we provide a wide range of resources and services to help you in your studies.

Take a look at the online exam resources available to you on icaew.com/examresources and discover more resources and services at icaew.com/studentbenefits.

Syllabus, skills development and technical knowledge grids

This syllabus presents the learning outcomes for each exam and should be read in conjunction with the relevant technical knowledge grids and, where applicable, the skills development grids.

Exam support

A variety of exam resources and support have been developed on each exam to help you on your journey to exam success. This includes exam guidance, sample exams, hints and tips from examiners and tutors, on-demand webinars and articles.

Past exams and mark plans

Use past exams to practise answering questions. The mark plans will help you check your answers. The past exams and mark plans are included in your Question Bank and have been updated to reflect the 2021 legislation and syllabus.

Errata sheets

These documents will correct any omissions within the learning materials once they have been published. You should refer to them when studying.

Exam software

It is vital that you are familiar with the exam software before you take your exam. Access a variety of resources, including the practice software and sample exams at icaew.com/studentresources.

Student support team

Our student support team is here to help and advise you, so do not hesitate to get in touch. Email studentsupport@icaew.com or call +44 (0)1908 248 250. If you are browsing our website, look out for the live help boxes. You will be able to speak directly to an adviser. Mia, our ChatBot, is also on hand to answer your queries.

Online student community

The online student community is the place where you can post your questions and share your study tips. Join the conversation at icaew.com/studentcommunity.

ICAEW Quarterly and Student Insights

As an ACA student, you will also receive a copy of our member magazine, *Quarterly*. Read more at icaew.com/insights.

You'll also be able to access our practical and topical student content on our dedicated online student hub, Student Insights.

You'll find new-look features, interviews and guides giving you fresh insights, innovative ideas and an inside look at the lives and careers of our ICAEW students and members. No matter what stage you're at in your journey with us, you'll find content to suit you.

Tuition

The ICAEW Partner in Learning scheme recognises tuition providers who comply with our core principles of quality course delivery. If you are not receiving structured tuition and are interested in doing so, take a look at ICAEW recognised Partner in Learning tuition providers in your area at icaew.com/dashboard.

CABA

It can be tough juggling your studies with work, planning for the future and finding time to unwind. CABA are an independent charity that supports the well-being of the chartered accountant community. So, if you need support at home or at work, CABA is there for you. They provide information, advice and lifelong support to ACA students across the world face-to-face, over the phone and online. All their services are completely free and strictly confidential. Find out more at caba.org.uk.

ICAEW Business and Finance Professional (BFP)

ICAEW Business and Finance Professional (BFP) is an internationally recognised designation and professional status. It demonstrates your business knowledge, your commitment to professionalism and that you meet the standards of a membership organisation. Once you have completed the ICAEW CFAB qualification or the ACA Certificate Level, you are eligible to apply towards gaining BFP status. Start your application at icaew.com/becomeabfp.

Skills within the ACA

Professional skills are essential to accountancy and your development of them is embedded throughout the ACA qualification.

The level of competency required in each of the professional skills areas to pass each module exam increases as ACA trainees progress upwards through each Level of the ACA qualification. The skills progression embedded throughout the ACA qualification ensures ACA trainees develop the knowledge and professional skills necessary to successfully operate in the modern workplace and which are expected by today's forward-thinking employers.

The following professional skills areas are present throughout the ACA qualification.

Skill area	Overall objective
Assimilating and using information	Understand a business or accounting situation, prioritise by determining key drivers, issues and requirements and identify any relevant information.
Structuring problems and solutions	Structure information from various sources into suitable formats for analysis and provide creative and pragmatic solutions in a business environment.
Applying judgement	Apply professional scepticism and critical thinking to identify faults, gaps, inconsistencies and interactions from a range of relevant information sources and relate issues to a business environment.
Concluding, recommending and communicating	Apply technical knowledge, skills and experience to support reasoning and conclusion and formulate opinions, advice, plans, solutions, options and reservations based on valid evidence and communicate clearly in a manner suitable for the recipient.

The following provides further detail on the professional skills that you will develop in this particular module. To see the full skills development grids, please go to icaew.com/examresources.

Assimilating and using information

Understand the situation and the requirements

- Demonstrate understanding of the business context
- Recognise new and complex ideas within a scenario
- Identify the needs of customers and clients
- Explain different stakeholder perspectives and interests
- Identify risks within a scenario
- Identify elements of uncertainty within a scenario
- Identify ethical issues including public interest and sustainability issues within a scenario

Identify and use relevant information

- Interpret information provided in various formats
- Evaluate the relevance of information provided
- Use multiple information sources
- Filter information provided to identify critical facts

Identify and prioritise key issues and stay on task

- Identify business and financial issues from a scenario
- Prioritise key issues
- Work effectively within time constraints
- Operate to a brief in a given scenario

How skills are assessed: students may be required to:

- absorb and understand both structured and unstructured material; and

- give recommendations based on their understanding and interpretation of the information provided, supported by explanation of the reasoning behind and implications of their recommendations.

Structuring problems and solutions

Structure data

- Structure information from various sources into suitable formats for analysis
- Identify any information gaps
- Frame questions to clarify information
- Use a range of data types and sources to inform analysis and decision making
- Structure and analyse financial and non-financial data to enhance understanding of business issues and their underlying causes
- Present analysis in accordance with instructions and criteria

Develop solutions

- Identify and apply relevant technical knowledge and skills to analyse a specific problem
- Use structured information to identify evidence-based solutions
- Identify creative and pragmatic solutions in a business environment
- Identify opportunities to add value
- Identify and anticipate problems that may result from a decision
- Identify a range of possible solutions based on analysis
- Identify ethical dimensions of possible solutions
- Select appropriate courses of action using an ethical framework
- Identify the solution which is the best fit with acceptance criteria and objectives
- Define objectives and acceptance criteria for solutions

How skills are assessed: students may be required to:

- assimilate significant amounts of information, to analyse it (including quantitative analysis) in a way that demonstrates relevant technical knowledge and to draw and support appropriate conclusions.

Applying judgement

Apply professional scepticism and critical thinking

- Recognise bias and varying quality in data and evidence
- Identify assumptions or faults in arguments
- Identify gaps in evidence
- Identify inconsistencies and contradictory information
- Assess interaction of information from different sources
- Exercise ethical judgement

Relate issues to the environment

- Appreciate when more expert help is required
- Identify related issues in scenarios
- Assess different stakeholder perspectives when evaluating options
- Retain an overview of the business issue or scenario
- Appraise corporate responsibility and sustainability issues
- Appraise the effects of alternative future scenarios
- Appraise ethical, public interest and regulatory issues

How skills are assessed: students may be required to:

- make sense of relatively large volumes of data, making judgments on the relevance of data for use in subsequent calculations and discussions;
- reflect on their calculations and the methodology employed and to identify and discuss the implications of calculations; and

- make and justify judgements based on earlier calculations.

Concluding, recommending and communicating

Conclusions

- Apply technical knowledge to support reasoning and conclusions
- Apply professional experience and evidence to support reasoning
- Use valid and different technical skills to formulate opinions, advice, plans, solutions, options and reservations

Recommendations

- Present recommendations in accordance with instructions and defined criteria
- Make recommendations in situations where risks and uncertainty exist
- Formulate opinions, advice, recommendations, plans, solutions, options and reservations based on valid evidence
- Make evidence-based recommendations which can be justified by reference to supporting data and other information
- Develop recommendations which combine different technical skills in a practical situation

Communication

- Present a basic or routine memorandum or briefing note in writing in a clear and concise style
- Present analysis and recommendations in accordance with instructions
- Communicate clearly to a specialist or non-specialist audience in a manner suitable for the recipient
- Prepare the advice, report, or notes required in a clear and concise style

How skills are assessed: students may be required to:

- recommend suitable courses of action in a given situation (financing decisions, dividend decisions, investment appraisal decisions); and
- incorporate advice within a 'business report' format, addressing both the strengths and weaknesses of any recommendations and/or reasons for the rejection of alternatives.

To help you develop your ability to demonstrate competency in each professional skills area, each chapter of this Workbook includes up to four Professional Skills Guidance points.

Each Professional Skills Guidance point focuses on one of the four ACA Professional Skills areas and explains how to demonstrate a particular aspect of that professional skill relevant to the topic being studied. You are advised to refer back to the Professional Skills Guidance points while revisiting specific topics and during question practice.

Chapter 1

Stamp taxes

Introduction

Learning outcomes

- Determine, explain and calculate the tax liabilities for individuals and corporate entities, including income tax, national insurance, corporation tax, diverted profits tax, stamp taxes, VAT and annual tax on enveloped dwellings (ATED)
- Explain and evaluate the tax implications of group structures
- Explain and evaluate the tax implications of business transformations and change
- Explain and calculate the tax implications involved in the cessation of trade
- Evaluate and advise on tax strategies to meet business objectives
- Evaluate and advise on alternative tax strategies relating to corporate transformations
- Evaluate and advise on alternative strategies relating to changes in an individual's circumstances such as marriage, divorce and death

Specific syllabus references for this chapter are 1g, 1k, 1m, 1n, 2b, 2c and 2d.

Syllabus links

Both stamp duty and stamp duty land tax are likely to be relevant in any corporate transformation. The impact of stamp duty land tax on incorporation can be significant. Stamp duty land tax also interacts with the calculation of VAT due.

Examination context

Similarly to VAT, stamp taxes add significant sums of money to the cost of a transaction and must not be overlooked. For tax professionals the interaction of VAT and stamp taxes on property can become tax planning nightmares if not correctly dealt with.

In the exam students may be required to:

- advise on the correct treatment of and calculate the tax liabilities arising as a result of the acquisition, intra-group transfer, or disposal of property; and
- advise on the correct treatment of and calculate the tax liabilities arising as a result of the acquisition, intra-group transfer, or disposal of shares.

Chapter study guidance

Use this schedule and your study timetable to plan the dates on which you will complete your study of this chapter.

Topic	Practical significance	Study approach	Exam approach	Interactive questions
1	**Stamp duty** Stamp taxes between them raise a large sum for the Treasury each year (approximately 3% of total UK government receipts) and can be very expensive for a business. Due to the complexity of the rules and the short time period between the	**Approach** Most of this chapter is revision from Tax Compliance. Make sure you understand when SD/SDRT and SDLT apply. Note that group relief is withdrawn in certain circumstances.	Transactions involving share reorganisations are commonly tested in the exam and calculating the stamp duty payable could give a few easy marks. You may be asked to advise on the correct treatment of and calculate the tax liabilities arising as a result of the acquisition, intra-group	

Topic	Practical significance	Study approach	Exam approach	Interactive questions
	transaction and payment of the stamp duty, this is an area where companies and individuals often seek professional advice.	**Stop and think** Stamp duty group relief could be denied in a liquidation scenario so timing of transfers can be very important.	transfer, or disposal of shares. The rules for group relief are also highly examinable and may to be tested in any group question.	
2	**Stamp duty reserve tax** Stamp duty reserve tax is payable on the electronic transfer of shares and securities and is now the largest source of stamp duty revenue on share transfers.	**Approach** Make sure you can identify the differences, particularly in payment dates and rounding between stamp duty and stamp duty reserve tax. **Stop and think** Do you think stamp duty or stamp duty reserve tax would be easier administratively?	Stamp duty reserve tax is likely to be examined in similar scenarios to stamp duty.	
3	**Stamp duty land tax** Stamp duty land tax is payable both on the purchase of property and when a lease is granted. Because stamp duty rates are much lower than SDLT rates, SDLT avoidance involving transferring expensive houses to companies (so that later sales of the property were sales of the shares) had become increasingly common. To counter this anti-avoidance legislation exists as a 15% rate of SDLT on transfers of residential properties to companies and the Annual Tax on Enveloped Dwellings (ATED).	**Approach** Although you should not need to remember the bandings, be aware that there are different rates of SDLT for residential and non-residential property and additional rates of SDLT for additional residential properties and for companies. Review the worked example on this carefully. Ensure you understand that you are happy with how SDLT is calculated on leases. **Stop and think** What difference would it make to pay SDLT at 15% instead of usual rates on a residential property	This may be tested for a few marks as part of a wider scenario. You may be asked to advise on the correct treatment of, and calculate the tax liabilities arising as a result of, the acquisition, intra-group transfer, or disposal of property. This could be in conjunction with considering the VAT or capital gains position.	**IQ SDLT on a lease premium** Tests your understandin g of SDLT on lease premiums.

Topic	Practical significance	Study approach	Exam approach	Interactive questions
		worth £1m?		
4	**Stamp duty on incorporation or liquidation** Incorporation and liquidation are two key aspects of business transformation therefore understanding the stamp tax considerations of this will form a key part of any advice.	**Approach** Although this section is short, ensure you have reviewed it thoroughly and understand the key aspects as this section is new. **Stop and think** How does stamp duty payable on incorporation different from that payable on the acquisition of a company.	As above, this section could give you some quick high level marks in a wider question about incorporation or liquidation. You may be asked to calculate the stamp taxes payable.	
5	**High value properties** This legislation was introduced to tackle avoidance from transferring residential property into companies to avoid SDLT on their later sale.	**Approach** Work through this section and complete the worked example, before looking at the answers, to ensure you understand when ATED applies. **Stop and think** Do you think these measures have remove the benefit of transferring property into a company if future sale is expected?	This may be tested as part of a wider question on business transformation eg a sole trader selling a business to a company.	

Once you have worked through this guidance you are ready to attempt the further question practice included at the end of this chapter.

1 Stamp duty

Section overview

- Stamp duty is payable at 0.5% on shares and securities transferred via a stock transfer form.
- There are exemptions for transfers for no consideration such as gifts.
- Stamp duty also applies on the repurchase of a company's own shares (subject to certain exemptions).
- Stamp duty relief exists for transfers of the beneficial interest of shares between members of a 75% group.
- Anti avoidance rules apply to use market value for consideration on the transfer of securities to a connected company.
- Stamp duty is payable by 30 days after the execution on presentation of the transfer form.
- Interest is charged for late payment of duty.
- A penalty may be charged for late presentation of the transfer form.

Definition

Stamp duty: Stamp duty is payable on the transfer of shares and securities where the transfer is made using a stock transfer form.

Stamp taxes are of particular importance at Business Planning Taxation. Transactions involving change and reorganisation or the adoption of new business strategies are highly likely to incur stamp taxes. The difference between the rate of stamp duty on the purchase of shares (0.5%) and the rate of stamp duty land tax on the purchase of property (maximum of 15% or 5% depending on whether the property is residential or non-residential, respectively) is especially relevant.

- Stamp duty and stamp duty reserve tax apply to the transfer of existing shares and securities.
- Stamp duty land tax applies to the transfer of land and buildings.
- Other assets are not subject to stamp taxes.

Professional skills focus: Assimilating and using information

Although stamp taxes would likely only be one of several tax consequences in an example, the tax saving of paying stamp duty compared to paying SDLT could be significant to your overall conclusions. Accordingly, you will need to use your assimilation skills in order to recognise whether stamp taxes could be relevant to your analysis from the information given.

2.1 Charge to stamp duty

Stamp duty is payable on the transfer of shares and securities where the transfer is made using a stock transfer form. Stamp duty can only be charged where an instrument, in this case a stock transfer form, is used to execute the transfer. For paperless transactions stamp duty reserve tax applies instead.

The rate of stamp duty is 0.5% of the consideration. This is called ad valorem duty as it is imposed on the value of the consideration.

The duty is payable by the person acquiring the shares.

The duty is rounded up to the nearest £5.

However, stamp duty is not chargeable if the value of the consideration is £1,000 or less. In these cases, the stock transfer form does not need to be presented to HMRC and can be sent directly to the company registrar.

Worked example: Stamp duty

Julie sells her shares in R Ltd to Colin for £72,480.

Requirement

Compute the stamp duty payable by Colin.

Solution

£72,480 × 0.5% = £362 rounded up to £365

2.2 Stamp duty exemptions

There are exemptions from stamp duty for certain transactions where there is no consideration for the transfer such as:

- gifts
- divorce arrangements
- received via a will on death
- securities admitted to trading on a recognised growth market (eg, AIM) but not listed on that or any other market

The last exemption was introduced to encourage growth in smaller companies.

The transfer must state which exemption is being claimed. The categories are usually printed on the back of the stock transfer form.

2.3 Purchase of own shares

When a company purchases its own shares, the shares are surrendered by the shareholder without the need for a stock transfer form. However, the company is required to file a return providing details of the purchase with the Registrar of Companies House.

This return is treated as an instrument of transfer and is subject to stamp duty at 0.5%. This does not apply to:

- redemption of redeemable shares in accordance with their terms of issue;
- cancellation of shares on a reduction of capital or a Court scheme of arrangement; or
- cancellation of the shares following a repurchase by the company (ie, only the repurchase is subject to stamp duty and there is not a second charge on cancellation).

There is no charge to stamp duty reserve tax as there is no agreement to 'transfer'.

2.4 Transfers between group companies - stamp duty group relief

Relief from stamp duty is available for certain intra group transfers of shares. Relief is given where:

- the effect of the instrument is to transfer the beneficial interest in the shares; and
- one company is the parent of the other or they both have a common parent.

One company is the parent of the other if it has at least 75% of the ordinary share capital directly or indirectly (as for group relief) and a 75% interest in dividends and assets on a winding up. It is necessary for there to be a parent company ie, two companies owned by the same individual do not constitute a group. This exemption also applies if one of the companies is non-UK resident.

Where a group company is being liquidated careful consideration should be given to the timing of the distribution of assets to avoid a liability to stamp duty. Stamp duty group relief will be denied once winding up has commenced as the company no longer has beneficial ownership of the assets. However, transfers of assets in consideration of shareholder's rights in a liquidation are exempt from stamp duty providing the shareholder does not take over any liabilities of the liquidating company.

Worked example: Transfer between group companies

Sparrow Ltd owns 88% of the ordinary share capital of Vulture Ltd, which in turn owns 86% of the ordinary share capital of Cuckoo Ltd.

Shares are transferred from Sparrow Ltd to Cuckoo Ltd under an instrument executed on 1 September 2021

Requirement

Is the transfer liable to stamp duty?

Solution

Stamp duty is not payable as the transaction qualifies for relief. Both Sparrow Ltd and Cuckoo Ltd are part of a group. Sparrow Ltd owns at least 75% (88% × 86% = 75.7%) indirectly in Cuckoo Ltd.

2.5 Share for share relief

Stamp duty share for share relief is available where shareholders swap shares in one company (the target company) for newly issued shares of another company (the acquiring company), which is inserted above the target company as part of a company reconstruction. The shareholders in the acquiring company after the share for share exchange must be the same as those in the target company immediately before.

However, the relief is not available where, at the time of the exchange, arrangements are in place for a change of control of the acquiring company.

2.6 Transfer of listed and unlisted securities to connected companies

From 29 October 2018 targeted anti-avoidance legislation applies so that, where listed shares or securities are transferred to a connected company, the stamp duty is calculated on the higher of:

- the value of actual consideration; and
- the market value of the securities transferred.

In this situation connected means:

- two companies are connected if the same person(s) control them (including where one individual controls one company and a connected person of theirs controls the other)
- an individual or individuals are connected to a company if they control the company

Control is when a person owns shares or voting rights, and as a result the company must act in accordance with their wishes.

In addition, from the date of Royal Assent of Finance Act 2020, this market value override will also apply to transfers of unlisted shares to a connected company where the consideration consists of, or includes, the issue of new shares.

2.7 Stamp duty administration

Stamp duty is administered by HMRC Stamp Taxes.

The stock transfer form must be presented to HMRC by 30 days after the date of execution and the duty paid at that time.

Interest may be charged if the duty is paid late. Interest runs from the end of the 30-day period to the day before the duty is paid. Interest is rounded down to the nearest multiple of £5 and is not charged if the amount is less than £25.

In addition, a penalty may be imposed if the transfer is presented late for stamping. In straightforward cases HMRC will usually charge the following penalties:

Length of delay	Penalty
Documents late by up to 12 months	10% of the duty, capped at £300
Documents late by 12 to 24 months	20% of the duty

Length of delay	Penalty
Documents late by more than 24 months	30% of the duty

The penalty will not be charged if less than £20. Penalties are rounded down to the nearest multiple of £5. For delays of 12 months or more, the penalties may be higher than those given above if there is evidence of a deliberate failure to present documents for stamping. The penalty then depends on the type of failure (ie, whether deliberate, or deliberate and concealed), whether the disclosure is unprompted or prompted and when the failure is disclosed.

The penalty can be reduced for reasonable excuse.

3 Stamp duty reserve tax

Section overview

- Stamp duty reserve tax (SDRT) is payable at 0.5% on the paperless electronic transfer of shares and securities.
- There are few direct exemptions from SDRT but if a transaction is exempt from stamp duty then normally no stamp duty reserve tax is payable.
- Anti-avoidance applies to use market value for consideration on the transfer of securities to a connected company.
- SDRT is payable on the seventh day of the month following the month of sale if not made through CREST.
- SDRT is payable 14 days after the trade date if via CREST.

Definition

Stamp duty reserve tax: SDRT is payable on the paperless ie electronic transfer of shares and securities. Most such transfers are executed via the CREST system.

4.1 Charge to stamp duty reserve tax

Stamp duty depends on there being a document which can be stamped. It is not able to cope with paperless transactions. For that reason, stamp duty reserve tax (SDRT) was introduced in 1986. SDRT is now the largest source of stamp duty revenue on share transfers. SDRT is payable on the paperless ie, electronic transfer of shares and securities. Most of these transfers are executed via the CREST system.

The principal charge to SDRT is on agreements to transfer 'chargeable securities' (most stocks and shares) for consideration in money or money's worth. SDRT applies instead of stamp duty where the transfer is not completed by an instrument of transfer (ie, by a stock transfer form stamped with ad valorem duty).

The rate of duty is 0.5% of the consideration. Unlike stamp duty, there is no rounding.

4.2 Stamp duty reserve tax exemptions

If there is no consideration in money or money's worth there is usually no SDRT charge.

4.3 Transfer of listed and unlisted securities to connected companies

From 29 October 2018 targeted anti-avoidance legislation applies so that, where listed shares or securities are transferred to a connected company, the stamp duty reserve tax is calculated on the higher of:

- the value of actual consideration; and
- the market value of the securities transferred.

In this situation connected means:

- two companies are connected if the same person(s) control them (including where one individual controls one company and a connected person of theirs controls the other)
- an individual or individuals are connected to a company if they control the company

Control is when a person owns shares or voting rights, and as a result the company must act in accordance with their wishes.

In addition, from the date of Royal Assent of Finance Act 2020, this market value override will also apply to transfers of unlisted shares to a connected company where the consideration consists of, or includes, the issue of new shares.

This is the same rule that applies for stamp duty (section 1.6).

4.4 Cancellation of stamp duty reserve tax

To prevent a double charge to both stamp duty and SDRT, any SDRT paid on an agreement to transfer shares will be repaid if the transaction is subsequently completed by a stamped stock transfer form. Normally, if the subsequent stock transfer form is exempt from stamp duty it will also be exempt from SDRT and any SDRT paid will still be repaid.

4.5 Exemptions

Securities admitted to trading on a recognised growth market (eg, AIM) but not listed on that or any other market are exempt from SDRT.

In addition, where a duly stamped transfer document can be produced which states that the transfer is free from stamp duty it will lead to the cancellation of the stamp duty reserve tax. Thus an intra group transfer qualifying for stamp duty relief will also be exempt from SDRT.

4.6 Stamp duty reserve tax administration

Stamp duty reserve tax is administered by HMRC Stamp Taxes but is actually collected automatically via stock brokers.

Stamp duty reserve tax has to be reported by and is payable on the seventh day of the month following the month in which the agreement was made or became unconditional. If, however, the payment is capable of being made via CREST it should be paid over by 14 calendar days after the trade date.

5 *Stamp duty land tax*

Section overview

- Stamp duty land tax (SDLT) is payable on the transfer of land and buildings at various rates depending on the title transferred (freehold or leasehold) and the use to which the land is put.
- Where there is chargeable consideration, SDLT is charged at various rates on the chargeable consideration.
- The rate of SDLT depends on whether the land is residential or non-residential.
- There is also a charge to SDLT on a grant of a lease based on the Net Present Value of the rents receivable over the term of the lease.

- SDLT is not charged where the transfer is made between members of a 75% group for bona fide commercial reasons.
- A land transaction form must usually be delivered to HMRC by 14 days after the transaction and the SDLT paid at that time.
- Interest is payable on late paid SDLT.
- There are penalties for late delivery of a land transaction form.

Definition

Stamp duty land tax: SDLT is chargeable on land transactions. Examples include the transfer of freehold land, the assignment of a lease and the grant of a lease.

In the exam you will need to be aware of different stakeholder perspectives. For example, SDLT could be an additional cost for a purchaser compared to stamp duty on the purchase of shares (subject to anti-avoidance).

6.1 Charge to SDLT

Stamp duty land tax (SDLT) is chargeable on land transactions. Examples include the transfer of freehold land, the assignment of a lease and the grant of a lease.

Where a land transaction is made for chargeable consideration (payment in money or money's worth), there is a charge to SDLT based on the amount of that consideration. It is based on the VAT inclusive amount.

SDLT is payable by the purchaser, and the land transaction form must be submitted by 14 days after the transfer.

The rate of SDLT depends on whether the land is used for residential purposes or non-residential purposes.

Stamp duty land tax on the purchase price, lease premium or transfer value is calculated using the rates in the following table:

%	Residential	%	Non-residential
0[1,4]	£Nil – £125,000	0[2]	£Nil – £150,000
2[1,2,4]	£125,001 – £250,000	2[2]	£150,001 – £250,000
5[1,2,4]	£250,001 – £925,000	5[2]	£250,001 and over
10[1,2]	£925,001 – £1,500,000		
12[1,2]	£1,500,001 and over		

Note:

- A further 3% is charged in each band on the purchase of additional residential properties. This applies when a purchaser already owns a residential property and is buying another, for example to rent out (see below).
- For both residential and non-residential properties, SDLT is charged on the portion of the consideration within each band at the relevant rate.
- For leases, the lease premium is charged under the normal rules as if the lease premium were the chargeable consideration (using the table above).
- Since 22 November 2017, a first-time buyer purchasing a single property, as an only/main residence, for up to £500,000 pays no SDLT on the first £300,000 of purchase price, and 5% on

the remainder. There is no relief for a purchase price in excess of £500,000. From 29 October 2018 this relief also includes shared ownership property purchases. The first £300,000 of an initial share purchased has no SDLT with 5% on any excess. There is no SDLT on the lease element. There is no relief if the property is valued in excess of £500,000. Where SDLT was paid on such a property between 22 November 2017 and 29 October 2018 a repayment of SDLT can be claimed.

SDLT was replaced by Land and Buildings Transaction Tax (LBTT) in Scotland from 1 April 2015, and by Land Transaction Tax (LTT) in Wales from 1 April 2018. You should be aware of the existence of these taxes, but calculations involving LBTT and LTT will not be tested in the Business Planning: Taxation exam.

Where there are a number of linked transactions, the consideration is the total of the consideration for each transaction. However, there is relief for purchasers of residential property who acquire more than one dwelling via linked transactions. Where the relief is claimed, the rate of SDLT on the consideration attributable to the dwellings is determined not by the aggregate consideration but instead is determined by the mean consideration (ie, by the aggregate consideration divided by the number of dwellings).

6.1.1 Additional residential property

Since 1 April 2016, 3% has been added to each rate on the purchase of additional residential properties. This affects those individuals purchasing a second home or buy-to-let properties. Companies also pay an additional 3% on the purchase of any residential property – unless the 15% rate applies.

The additional 3% does not apply if:

- the transaction is less than £40,000; or
- the purchase is of a lease not exceeding 21 years.

The 3% additional charge is not intended to apply if the purchase is a replacement of the individual's only/main residence. A number of anti-avoidance measures are in place to prevent abuse of this rule.

Where an individual buys and sells a house on the same day (ie, they only have one only/main residence at midnight at the end of the day), the additional 3% will not be charged.

If the individual sold the first house before the second is purchased, the additional 3% will not be charged provided:

- the purchaser intends the new house to be his only/main residence; and
- the purchaser or spouse/civil partner have not purchased another main residence since the disposal.

If the individual has two houses at midnight at the end of the day of buying the second residential property (ie there is a period of overlap), the additional 3% will be charged. However, a refund can be claimed if:

- the purchaser intends the new house to be his only/main residence; and
- the purchaser or spouse/civil partner dispose of the previous main residence within three years of purchasing the second house.

Worked example: SDLT on sale of freehold land

Harold sells his house to his friend Lily for £375,000 on 10 April 2020 .

Requirements

1 Compute the SDLT payable by Lily, if she has never owned another property.

2 Compute the SDLT payable by Lily, if she already owns a house that she intends to keep.

3 Compute the SDLT payable by the purchaser if Lily had disposed of a non-residential property for £375,000

Solution

1 SDLT is calculated as follows:

	£
£300,000 × 0%	0
(£375,000 – £300,000) × 5%	3,750
SDLT payable is	3,750

As a first-time buyer of residential property (not exceeding £500,000) Lily pays at 0% on the first £300,000.

2 SDLT is calculated as follows:

	£
£125,000 × 3%	3,750
(£250,000 – £125,000) × 5%	6,250
(£375,000 – £250,000) × 8%	10,000
SDLT payable is	20,000

3 SDLT is calculated as follows:

	£
£150,000 × 0%	0
(£250,000 – £150,000) × 2%	2,000
(£375,000 – £250,000) × 5%	6,250
SDLT payable is	8,250

6.2 Lease rentals

On the grant of a lease, in addition to any SDLT payable on the premium (using SDLT table in section 3.1) SDLT is payable on the rental. The rental charge is based on the net present value of the rent payable to the landlord over the term of the lease. This is the total rent payable, discounted by 3.5% each year.

For exam purposes, you may take the NPV to be the total rents payable over the term of the lease ie, ignore discounting.

The rate of SDLT payable on the NPV of the rent is charged according to the following table.

%	Residential	Non-residential
0	Up to £125,000	Up to £150,000
1	Excess over £125,000	£150,001 – £5 million
2		Excess over £5 million

As for the calculation of SDLT on lease premiums and freeholds, the rates apply to the part of the NPV within each band.

Professional skills focus: Concluding, recommending and communicating

A common method of financing is via a sale and leaseback and SDLT payable will be one of the costs of this type of transaction. You will need to incorporate any calculations you have done to be able to provide an evidence-based recommendation to your client.

Worked example: SDLT on rental

Donald is granted a 25-year lease of a factory by Simon on 1 August 2020. He pays an annual rental of £9,000 per year for the term of the lease.

Requirement

Compute the SDLT payable by Donald

Solution

	£
Rental payable over term of lease	
£9,000 × 25	225,000
Less non-residential threshold	(150,000)
Amount chargeable	75,000
SDLT £75,000 × 1%	£750

Interactive question 1: SDLT on lease premium

G plc is granted a lease of a factory by T plc in December 2020. The lease is for seven years. The premium payable by G plc is £245,000 and the annual rent is £30,000.

Requirement

Compute the SDLT payable by G plc in respect of the lease.

See **Answer** at the end of this chapter.

6.3 SDLT exemptions

There are a number of exemptions from SDLT including transfers:

- for no chargeable consideration (eg, gifts);
- on divorce; and
- effecting a variation of a will.

In these cases, no land transaction form needs to be submitted to HMRC.

If land is transferred to a company which is connected with the transferor in exchange for shares, the transaction is not exempt. It is deemed to be made for chargeable consideration at least equal to the market value of the land. This situation could occur on the incorporation of a business.

Note that where responsibility for a debt is assumed by the purchaser, the value of the debt is treated as consideration and not an outright gift eg, an intra spouse transfer where the property transferred is subject to a mortgage.

6.3.1 SDLT group relief

An exemption from SDLT also applies on a transfer of land between members of a group of companies (75% ownership directly or indirectly, and 75% right to profits and right to 75% of assets on winding up) where:

- one company is the parent company of another company; or
- both companies have a common parent company.

Relief will be denied where at the time of the transfer arrangements exist for the two companies to cease to be members of the same group. Relief will also be denied where the transaction is not for bona fide commercial reasons or if the transaction forms part of arrangements of which the main purpose is tax avoidance.

SDLT will be charged retrospectively based on market value at the date of transfer if the transferee company leaves the group within three years while still owning the land transferred. This will be an issue where property is transferred as part of a hive down and the new company leaves the group within three years.

A land transaction form must be submitted in the usual way where there is a group transfer.

6.4 Higher rate for transfers to companies

Where an interest in a single dwelling is sold for an amount in excess of the 'higher threshold interest' the rate of SDLT is 15% (rather than the usual 5%, 10% or 12%) if the buyer is:

- a company;
- a partnership where at least one partner is a company; or
- a collective investment scheme.

The 'higher threshold interest' is £500,000 (£2 million prior to 20 March 2014).

This measure is designed to combat SDLT tax avoidance where increasingly 'expensive' properties were being transferred to companies, so that after a one-off charge to SDLT further transfers only attracted stamp duty at a rate of 0.5%. The 15% rate does not apply where a property developer acquires the dwelling solely for the purpose of developing and reselling the land.

Where a residential property has been transferred to a company, partnership or collective investment scheme and the 15% rate of stamp duty land tax has applied, the annual tax on enveloped dwellings will often apply. This is explained at the end of this chapter.

7 *Stamp duty on incorporation or liquidation*

Section overview

- On incorporation, the company is liable to pay SDLT on any land or buildings transferred to it. However, the sole trader is not liable to pay stamp duty on an issue of new shares received.
- If land or buildings are transferred to the shareholders as part of a liquidation, SDLT is not payable by the shareholder providing no consideration is given.

8.1 Incorporation

For further details on the taxation implications of incorporation see Chapter 23.

The stamp duty costs of incorporation cannot be overlooked. When a business is incorporated, its assets are sold to the newly formed company.

The new company must therefore pay SDLT (at up to 5%) on the value of any commercial land or buildings included in the sale.

The percentage used will be based on the total value of any land transferred eg, if five separate buildings are transferred each worth £200,000 the total value is £1 million and therefore 5% SDLT applies on the top £750,000 (plus some at 2%).

Ownership of the land or buildings may be retained by the individual personally to avoid payment of the SDLT but this would then prevent the application of s.162 TCGA 1992 incorporation relief. However, gift relief under s.165 TCGA 1992 could be claimed instead.

If the transfer qualifies as a transfer of a going concern (TOGC) it will not be liable to VAT and the SDLT will be calculated only on the actual value of the land transferred. If the transfer does not qualify as a TOGC, then SDLT will be payable on the VAT inclusive value of the land (see Chapter 18).

When the sole trader receives shares in exchange for the assets transferred to the company, no stamp duty will be payable assuming the shares are a new issue of shares. Stamp duty is only payable on the transfer of existing shares.

8.2 Liquidation

For further details on the taxation implications of liquidations see Chapter 17.

SDLT may be payable on any land transferred to the shareholders, if any consideration is given. If the land is simply distributed to the shareholders under the liquidation, no SDLT will be payable.

The shares will then be cancelled by the company and no stamp duty is payable.

9 High value properties

Section overview

- This is anti-avoidance legislation, reflecting the fact that SDLT was being avoided by transferring expensive residential properties to companies so that later transfers only attracted 0.5% stamp duty rather than higher rate SDLT.
- The annual tax on enveloped dwellings (ATED) applies an annual charge based on the value of the property, to dwellings worth more than £500,000.

10.1 Background

The annual tax on enveloped dwellings (ATED) was introduced by FA 2013 because a significant number of residential properties had been transferred to companies in order to avoid SDLT on their later sale. Both UK resident and non-UK resident companies are within the scope of the rules if they own an interest in a dwelling in the UK worth more than £500,000 (pre 6 April 2016: £1 million).

The 15% stamp duty charge (see above) was intended to reduce the number of future transfers of residential property to companies. However, ATED applies to both newly transferred properties, and properties which have been owned by companies for a number of years.

10.2 Annual tax on enveloped dwellings (ATED)

ATED is charged for years from 1 April to 31 March.

10.2.1 Scope

ATED applies to:

- owners of interests in an individual UK dwelling worth more than £500,000, where
- the owner is a company, collective investment scheme, or partnership where at least one of the partners is a company or collective investment scheme.

10.2.2 Valuation

Property was initially valued at 1 April 2012 with the ATED charge based on its market value at the later of 1 April 2012 and the date on which the owner acquired the interest.

Properties are revalued every five years. From 2018/19 the ATED charge is based on market value at the later of 1 April 2017 and the date on which the owner acquired the interest. For newly built or converted properties, it is the value at the earlier of the date when the property is entered onto the Council Tax valuation lists and the date on which it is first occupied.

10.2.3 Amount of charge

The annual charge is as follows:

Property value	Annual charge	Annual charge
	2020/21	2019/20
Up to £500,000	N/A	N/A

Property value	Annual charge	Annual charge
	2020/21	**2019/20**
£500,001 – £1,000,000	£3,700	£3,650
£1,000,001 – £2,000,000	£7,500	£7,400
£2,000,001 – £5,000,000	£25,200	£24,800
£5,000,001 – £10,000,000	£58,850	£57,900
£10,000,001 – £20,000,000	£118,050	£116,100
£20,000,001 or more	£236,250	£232,350

Where a property is acquired or sold part way through the year, the charge is pro-rated based on the number of days when it is owned.

10.2.4 Reliefs

There are a number of reliefs which eliminate the ATED charge. These include (among others) reliefs for:

- properties exploited as part of a property rental business;
- property developers and traders; and
- unoccupied properties where steps are being taken to sell, demolish or convert them without undue delay.

Professional skills focus: Structuring problems and solutions

As the ATED charge was a measure introduced to combat anti-avoidance by transferring properties into companies, you may be required in the exam to evaluate the taxation impact of a transaction eg evaluating whether ATED would be payable following the transfer of a property to a company,

Worked example: ATED

Jayhome Ltd owns two residential properties, one in London and one in Manchester. The freehold of the Manchester property is worth £1,500,000 but Jayhome Ltd only owns a 20-year lease worth £400,000. The freehold is owned by an unrelated property investment company.

The London property was bought in February 2011 for £4,300,000. Its value on 1 April 2012 was estimated at £4,500,000 and its value at 1 April 2017 estimated at £6,200,000. It was rented out as part of a property rental business from the time of its acquisition until 31 December 2020. Since that time, the property has been lived in by Jake Hughes, the sole shareholder of Jayhome Ltd.

Requirement

Determine the ATED payable by Jayhome Ltd for the year to 31 March 2021.

Solution

There is no charge in relation to the Manchester property. Although the freehold is worth more than £500,000, the interest owned by the company is worth less than that. If Jayhome Ltd had been connected with the company owning the freehold it might have been necessary to consider the combined value of the interests, but as they are not connected this is not relevant.

The charge for the London property is based on its market value at 1 April 2017 (1 April 2017 revaluation is used from 1 April 2018), so the full annual charge would be £58,850. However, as an exemption applies for the period from 1 April to 31 December 2020, the charge is reduced to 3/12 × £58,850 = £14,713.

10.2.5 ATED administration

In general an ATED return has to be completed and returned, and the tax paid, within 30 days of the beginning of the chargeable year. The return for the year from 1 April 2021 to 31 March 2022 must therefore be submitted by 30 April 2021, and the tax payment made by the same date.

If you acquire an ATED dwelling part way through the chargeable year, the return and tax are due 30 days after the date of purchase (90 days where the dwelling is newly built). If you dispose of an interest part-way through a chargeable year, or an exemption starts to apply, an amended return must be submitted before a refund can be claimed.

A 'relief declaration return' can be submitted instead of a normal ATED return where a relief (see section 5.2.4) is available to eliminate the ATED charge.

Penalties apply to:

- errors in returns;
- late filing of returns; and
- late payment of ATED (in addition to interest).

The penalties are based on the same rules as those which apply for most other taxes. Penalties of between 30% and 100% of the tax due can apply for late filing and incorrect returns, depending on whether or not the failure was deliberate and whether it was concealed. Penalties for late paid tax are 5% of the tax at each of 30 days after the payment was due, and five months and 30 days after the payment was due, and 11 months and 30 days after the payment was due.

Summary

Further question practice

1 Knowledge diagnostic

Before you move on to question practice, complete the following knowledge diagnostic and check you are able to confirm you possess the following essential learning from this chapter. If not, you are advised to revisit the relevant learning from the topic indicated.

Confirm your learning	
1.	Can you list the exemptions from stamp duty? (Topic 1)
2.	Do you understand the requirements for stamp duty group relief to apply? (Topic 1)
3.	Do you know the payment dates for SD, SDRT and SDLT? (Topics 1, 2 and 3)
4.	Can you explain the rules concerning SDLT on incorporation or liquidation? (Topic 4)
5.	Can you explain the anti-avoidance measures for high value properties transferred to companies (ATED and higher rate of SDLT)? (Topics 3 and 5)

2 Question practice

Aim to complete all self-test questions at the end of this chapter. The following self-test questions are particularly helpful to further topic understanding and guide skills application before you proceed to the next chapter.

Question	Learning benefit from attempting this question
Dog Ltd	Revision of the stamp duty calculation including the difference between market value and consideration.
Hawks Ltd and Huxley House	Tests both calculation of stamp duty and SDLT on leases.
Charlotte	Important to test your understanding of the incorporation rules.
Pigsty Properties Ltd	Worth tackling this question as ATED and anti-avoidance is a new topic.

Once you have completed these self-test questions, it is beneficial to attempt the following questions from the Question Bank for this module. These questions have been selected to introduce exam style scenarios that will help you improve your knowledge application and professional skills development before you start the next chapter.

Question	Learning benefit from attempting this question
Lyre Ltd (Sale and leaseback only)	Revision of SDLT in a slightly different scenario where an asset has been sold and the leased back. The remainder of this question was a suggested question for chapter 13 Anti-avoidance for OMBs so if not attempted then you should be able to complete the entire question now.

Question	Learning benefit from attempting this question
Swell Gallery, parts 1 and 3 only	If this question was not attempted after Chapter 18, you should now be able to attempt the entirety of the suggested parts to test your understanding of both VAT and SDLT (and revise chapters 5 and 6).

Refer back to the learning in this chapter for any questions which you did not answer correctly or where the suggested solution has not provided sufficient explanation to answer all your queries. Once you have attempted these questions, you can continue your studies by moving on to the next chapter.

Technical reference

1 Stamp duty

- Ad valorem duty on shares – **Sch. 13 para 3 FA 1999**
- Exempt Instruments Regulations – **SI 1987/516**
- Transfers between group companies – **s.42 FA 1930**
- Exemption for transfer of assets in consideration of shareholder rights in a liquidation if shareholder assumes no liabilities of liquidating company – **SI 1987/516**
- Market value transfer of listed securities to a connected company – **s.47 FA 2019**
- Market value transfer of unlisted securities to a connected company – **s.47A FA2019**
- Interest on late stamping – **s.15A Stamp Act 1891**
- Penalties on late stamping – **s.15B Stamp Act 1891**

2 Stamp duty reserve tax

- References are to Finance Act 1986 (FA1986)
- The principal charge – **s.87**
- Exceptions – **s.90**
- Market value transfer of listed securities to a connected company – **s.48 FA 2019**
- Market value transfer of unlisted securities to a connected company – **s.48A FA2019**
- Repayment or cancellation of tax – **s.92**
- Definition of chargeable securities – **s.99**

3 Stamp duty land tax

- References are to Finance Act 2003 (FA 2003) unless otherwise stated
- Land transactions – **s.43**
- Deemed market value to be used where involves connected company – **s.53**
- Rates of SDLT – **s.55**
- Disadvantaged areas relief – **s.57**
- Leases – amount of tax chargeable on rent – **Sch. 5 para 2**
- Exemptions:
  - No chargeable consideration – **Sch. 3 para 1**
  - Divorce – **Sch. 3 para 3A**
  - Variations – **Sch. 3 para 4**
- Filing of land transaction form – **s.76**
- Payment of SDLT – **s.86**
- Interest on late payment – **s.87**
- Penalties on failure to deliver return – **Sch. 10 paras 3–4**

4 High value properties

Annual tax on enveloped dwellings (ATED) – **ss.94–174 FA 2013**

5 HMRC manual references

- Stamp duty land tax (found at www.gov.uk/hmrc-internal-manuals/stamp-duty-land-tax-manual)
- Introduction to stamp duty land tax (SDLT) – **SDLTM00010**
- Rates of tax – **SDLTM00050**
- Leases – **SDLTM10000**
- See also Stamp duty and other tax on property (found at www.gov.uk/topic/business-tax/stamp-taxes)

- See also Stamp Taxes on shares manual (found at www.gov.uk/hmrc-internal-manuals/stamp-taxes-shares-manual)

Self-test questions

Answer the following questions.

- Dog Ltd owns 100% of the shares in Cat Ltd and Mouse Ltd. Dog Ltd sells 10% of its existing holding in Cat Ltd to Edmund, a private individual, for £500,000. Dog Ltd sold the remaining 90% of its holding to Mouse Ltd. At the time of the transfer the 90% holding was worth £4.5 million although Mouse Ltd only paid £2 million.

  Requirement

  Calculate the stamp duty, if any, payable on the disposals

- **Hawks Ltd and Huxley House**

  Leopard Ltd is considering the following transactions, both of which would occur on 1 February 2021.

  (1) The purchase of existing shares in Hawks Ltd, a small UK trading company, for £53,000. Leopard Ltd would purchase 10% of the shares in this company from an unconnected company, the remainder being held by individuals.

  (2) Entering into a five year lease on Huxley House. Leopard Ltd would use Huxley House as office premises. The terms of the lease involve Leopard Ltd paying a premium of £72,500 on 1 February 2021 and rent of £29,600 pa, payable quarterly in advance. The landlord, Hepburn Ltd, has owned Huxley House for many years and also prepares accounts to 31 January each year.

  Requirement

  Describe the corporation tax and any stamp taxes consequences of the proposed transactions, using calculations to illustrate your answer

- Charlotte has decided to incorporate her business and will thus transfer ownership of the following assets to the newly formed company. In exchange Charlotte will receive 1,000 new shares issued at par £1.

	£
Freehold office building	180,000
Leasehold warehouse	400,000
Goodwill	333,450
Current assets:	
Stock	35,000
Cash	24,000
Debtors	12,000
Fixtures and fittings	98,341
Total	1,082,791

Requirement

Calculate the stamp duty and stamp duty land tax payable on incorporation.

- Pigsty Properties Ltd bought a house in the Cotswolds for £1,050,000 on 1 March 2020. The value of the house on 1 April 2012 was £850,000 and on 1 April 2017 was £980,000.

  On 1 June 2021 the house is sold to an unrelated third party for £1,150,000

  Requirement

  Calculate any ATED charges due. You should assume FA 2020 rates and allowances continue unchanged in future years.

Now go back to the Introduction and ensure that you have achieved the Learning outcomes listed for this chapter.

Answers to Interactive questions

Answer to Interactive question 1

SDLT on the lease premium:

	£
£150,000 × 0%	0
(£245,000 – £150,000) × 2%	1,900
SDLT payable is	1,900

SDLT on the lease rentals:

£30,000 × 7 years = £210,000

	£
£150,000 × 0%	0
(£210,000 – £150,000) × 1%	600
SDLT payable is	600

Total SDLT = £1,900 + £600 = £2,500

Answers to Self-test questions

1 Edmund has purchased an existing holding of shares and will therefore be personally liable to stamp duty at 0.5% ie £2,500.

Mouse Ltd has purchased an existing holding of shares from a connected company. Under the rules for transfers between group companies the transfer will be exempt from stamp duty where one company is the parent (75%) company of the other and the beneficial interest is transferred. In this case, Dog Ltd owns at least 75% in Mouse Ltd and therefore the transfer will be exempt from stamp duty.

2

(1) **Purchase of shares in Hawks Ltd**

Corporation tax

The purchase represents an acquisition of a chargeable asset, upon which corporation tax will be payable on sale by the vendor, unless the shareholding is sold in circumstances where the substantial shareholding exemption applies. This would require the shareholder to have owned a 10% holding for at least 12 months in the previous six years.

Stamp duty

Stamp duty of 0.5% on the consideration for the purchase of shares in Hawks Ltd is payable ie, £53,000 × 0.5% = £265

(2) **Five-year lease on Huxley House**

Hepburn Ltd – Landlord

Corporation tax

The rent receivable for the year ended 31 January 2022 of £29,600 will be subject to corporation tax as property income for Hepburn Ltd.

The income element of the premium received will also be subject to tax as property income (Chapter 22) for Hepburn Ltd in the year ended 31 January 2022 as follows:

$£72{,}000 \times \frac{50-4}{50}$	£66,700

Hepburn Ltd has granted a short lease out of its freehold/long leasehold interest and would therefore need to undertake a part disposal calculation or chargeable gains purposes.

Leopard Ltd – Tenant

Corporation tax

The accounting expense in relation to the depreciation of the right of use asset (excluding capital elements) and the finance cost of the lease liability will be deductible as an allowable trading expense for Leopard Ltd for the year ended 31 January 2022.

Leopard Ltd will also be entitled to a deduction against its trading profits for part of the lease premium paid. The trading profits deduction is calculated as the income element to the landlord spread over the life of the lease = £66,700/5 years = £13,340 pa.

Stamp duty land tax

Stamp duty land tax (SDLT) is payable on the NPV of rent charged.

There is no charge where the NPV is less than £150,000. In this case as the NPV of the rent charged is £29,600 × 5 = £148,000, no SDLT is payable on the rental.

As the premium is less than £150,000 (0% band) there is also no SDLT on the premium.

Tutorial note. Chargeable gains on leases is considered further in Chapter 22.

3 Charlotte will not pay stamp duty on the acquisition of the shares as it is not a transfer of an existing holding.

The company will pay SDLT on the composite value of all property transferred to it as it is connected to Charlotte and the transfer is made in exchange for shares. The total value of the (non-residential) land transferred is £580,000 and SDLT is therefore payable as follows:

	£
£150,000 × 0%	0
(£250,000 – £150,000) × 2%	2,000
(£580,000 – £250,000) × 5%	16,500
SDLT payable is	18,500

All other assets are exempt from stamp taxes.

4 The taxable value for ATED from 2018/19 to 2021/22 is the value on the later of 1 April 2017 and the purchase date, which is the purchase price of £1,050,000.

The taxable values exceed £500,000 throughout and Pigsty Properties Ltd will therefore be liable for an ATED charge from the time when the property is acquired until the time of its disposal.

The annual charge is £7,400 in 2019/20 and £7,500 in 2020/21 and 2021/22 (assumed in the question), but this is reduced where the property is only owned for part of the year. The ATED charges are therefore as follows:

Year ended 31 March 2020 – 1/12 × £7,400	£617
Year ended 31 March 2021 - full year's charge	£7,500
Year ended 31 March 2022 – 2/12 × £7,500	£1,250

Chapter 2

Consolidated statement of financial position

Introduction

Learning outcomes

- Identify the effects of transactions in accordance with the IASB *Conceptual Framework*
- Explain and demonstrate the concepts and principles surrounding the consolidation of financial statements
- Calculate from financial and other data the amounts to be included in an entity's consolidated financial statements in respect of its new, continuing and discontinued interests in subsidiaries, associates and joint ventures (excluding partial disposals of subsidiaries and disposals of associates or joint ventures) according to the international financial reporting framework
- Prepare and present the consolidated financial statements, or extracts, of an entity in accordance with its accounting policies and appropriate international financial reporting standards
- Explain the application of IFRS to specific group scenarios
- Describe the principal differences between IFRS and UK GAAP (FRS 102) and prepare simple extracts from consolidated financial statements in accordance with UK GAAP (FRS 102)

Specific syllabus references for this chapter are: 1d, 1h, 3d, 3e, 3f, 3g.

Syllabus links

This chapter looks in detail at the preparation of the consolidated statement of financial position and is fundamental to the *Financial Accounting and Reporting* syllabus. It builds on the principles introduced in Chapter 10 and applies them to more complex situations. A detailed knowledge and understanding of this topic will also be assumed at the Advanced Level.

Examination context

In the examination, candidates may be required to:

- Prepare a consolidated statement of financial position (or extracts) including the results of the parent entity and one or more subsidiaries from individual financial statements including adjustments for the following:
  - Acquisition, or disposal, of a subsidiary or acquisition of an associate, including midyear acquisitions (associate or subsidiary) or disposals (subsidiary)
  - Goodwill
  - Intra-group items
  - Unrealised profits
  - Fair values
  - Other consolidation adjustments
- Explain the process of preparing a consolidated statement of financial position in the context of the single entity concept, substance over form and the distinction between control and ownership
- Explain the two methods of measuring the non-controlling interest at acquisition and prepare financial information by the two methods
- Explain and illustrate the difference between the relevant treatment under IFRS and UK GAAP

Chapter study guidance

Use this schedule and your study timetable to plan the dates on which you will complete your study of this chapter.

Topic	Practical significance	Study approach	Exam approach	Interactive questions

1	**Consolidated statement of financial position workings.** In this chapter, we look in more detail at the consolidated statement of financial position introduced in Chapter 10. Topic 1 introduces the key workings required to prepare a consolidated statement of financial position in your exam.	**Approach** You have seen some of the standard workings for the consolidated statement of financial position in Chapter 10 already. Here in topic 1, we bring all these workings together, and then show how they are applied through IQ1. Work carefully through the question and make sure you properly debrief the solution to understand the techniques involved. **Stop and think** Why is information about the assets and liabilities of the subsidiary of more use to the shareholders than the cost of the investment in it?	One question in the exam will require the preparation of either a consolidated statement of financial position or a consolidated statement of profit or loss. Topic 1 introduces the workings you should use to prepare your answer.	**IQ1 Consolidated statement of financial position workings** This question demonstrates how the workings introduced in Topic 1 are applied to a scenario.
2	**Acquisition part-way through the reporting period** So far we have assumed all acquisitions are made on the first day of a reporting period. This is not the norm in real life! In Topic 2 we consider the effect the timing of an acquisition has on the standard workings given in Topic 1.	**Approach** Read the short section, then apply the principles to IQ2. Give yourself plenty of time to work through the solution to make sure you have grasped how an acquisition during the accounting period affects the consolidation workings. **Stop and think** Would the goodwill balance calculated in IQ2 be higher or lower if the acquisition had taken place on the first day of the reporting period?	In an exam question, the acquisition of a subsidiary could be at any point in the reporting period. You need to pay careful attention to the acquisition date in order to calculate net assets at acquisition appropriately.	**IQ2 Acquisition part-way through the reporting period** This question shows how the timing of an acquisition affects the standard consolidation workings.

		Why?		
3 & 4	**Intra-group balances** and **Unrealised intra-group profit** Group companies are likely to trade with each other – indeed this may be one of the reasons for acquiring a subsidiary in the first place. But on consolidation, the group is treated as a single entity, and a single entity cannot trade with itself. These topics deal with the adjustments we need to make to remove the effects of intra-group trading and intra-group transfers of non-current assets from group accounts.	**Approach** Read carefully through each of these topics, work through the worked examples and attempt each of the interactive questions as you go. In topic 3, the process for cancelling intra-group balances is important - the balances must agree, or be made to agree, before they can be cancelled. The worked example shows how to do this. In topic 4, the correct elimination of unrealised profit requires you to determine **which company made the sale.** Pay close attention as to why this is the case in the worked examples. **Stop and think.** Why is the profit on intra-group trading 'unrealised'? Why does it matter which company made the sale in an intra-group transaction?	In your exam, the consolidation question will always feature one or more consolidation adjustments, including those required for intra-group balances and unrealised profits. These adjustments may also feature in questions requiring discussion of principles.	**IQ3 Unrealised profits** This question works through the technique for eliminating unrealised intra-group profits. **IQ4 Non-current asset transfers** This question shows how unrealised profit on the transfer of non-current assets must be adjusted for.
5	**Fair value adjustments** As we saw in Chapter 10, the acquisition method requires the assets and liabilities of a subsidiary to be measured at their fair value at the acquisition date. If, at acquisition, the fair values of the subsidiary's net assets are different to their	**Approach** Read carefully through the topic before you and attempt IQ5. Carefully review the solution to IQ5 before having a go at IQ6. **Stop and think**	In your exam, the consolidation question will always feature one or more consolidation adjustments, including fair value adjustments. These adjustments may also feature in questions requiring discussion of principles.	**IQ 5 Fair value adjustments** This question shows the impact of a fair value adjustment relating to a non-depreciable asset (land) on

	carrying amounts, fair value adjustments are required on consolidation. This topic shows how we deal with these adjustments in the consolidated statement of financial position and their impact on the key consolidation workings, such as goodwill.	If, at acquisition, the fair value of a subsidiary's assets are higher than their carrying amount, will this have any effect on group profit?		the goodwill calculation. **IQ6 Fair value adjustments** This question shows the impact of fair value adjustments on the group accounts when the adjustment relates to a depreciable asset.
6	**Other consolidation adjustments** There are other issues that must be considered on consolidation: how do we deal with reserves of the subsidiary other than retained earnings? Does it matter if the subsidiary has a different accounting policy to the parent? These questions are addressed in this topic.	**Approach** Read through this short section and try IQ7. **Stop and think** What would be the result if we didn't adjust for the different accounting policies in IQ7?	In your exam, the consolidation question will always feature one or more consolidation adjustments. These could include dealing with other reserves or differing accounting policies. These adjustments may also feature in questions requiring discussion of principles.	**IQ7 Accounting policy alignments** This question shows how a consolidation adjustment can be used to align a subsidiary's accounting policy with that of the group.
7	**UK GAAP Comparison** There are some important differences between IFRS and UK GAAP in group accounting. For example, under UK GAAP, goodwill is amortised whereas IFRS 3 prohibits the amortisation of goodwill. This topic covers these differences.	**Approach** Read through the information carefully, making sure you understand the difference between FRS102 and IFRS. Some of the differences are significant - eg goodwill is amortised under UK GAAP. The worked example shows how the calculation of goodwill results in a different amount under UK GAAP than that calculated under IFRS.	A question could ask you to explain the differences seen in preparing a consolidated statement of financial position under UK GAAP compared to IFRS – for example, how would the calculation of goodwill differ under UK GAAP compared to IFRS.	

Once you have worked through this guidance you are ready to attempt the further question practice included at the end of this chapter.

1 Consolidated statement of financial position workings

Section overview

There are anumber of standard workings which should be used when answering consolidation questions.

2.1 Question technique

As questions increase in complexity, a formal approach to workings is needed. Review the standard workings below, then attempt Interactive question 1 Consolidated statement of financial position workings, which puts these into practice.

(a) Establish **group structure**

(b) Set out the **net assets of the subsidiary S Ltd**

	At year end	**At acquisition**	**Post-acquisition**
	£	**£**	**£**
Share capital	X	X	X
Retained earnings	X	X	X
	X	X	X

(c) Calculate **goodwill**

	£
Consideration transferred	X
Plus non-controlling interest at acquisition	X
	X
Less net assets at acquisition (W2)	(X)
	X
Impairment to date	(X)
Balance c/f	X

The double entry to consolidate the subsidiary will be:

		£	**£**
DR	Share capital (subsidiary)	X	
DR	Retained earnings / reserves (subsidiary)	X	
DR	Goodwill	X	
CR	Investment in subsidiary (parent)		X
CR	Non-controlling interest		X

(d) Calculate **non-controlling interest** (NCI) at year end

	£
At acquisition (NCI% × net assets at acquisition (W2) or NCI at fair value)	X
Share of post-acquisition profits and other reserves (NCI% × post-acquisition (W2))	X
	X

(e) Calculate **retained earnings**

	£
P Ltd (100%)	X
S Ltd (share of post-acquisition retained earnings (W2)	X
Goodwill impairment to date (W3)	(X)
Group retained earnings	X

Note: You should use the proportionate basis for measuring the NCI at the acquisition date unless a question specifies the fair value basis.

Interactive question 1: Consolidated statement of financial position workings

The following are the summarised statements of financial position of a group of companies as at 31 December 20X1.

	Rik Ltd	Viv Ltd	Neil Ltd
	£	£	£
Non-current assets			
Property, plant and equipment	100,000	40,000	10,000
Investments			
Shares in Viv Ltd (75%)	25,000		
Shares in Neil Ltd (2/3)	10,000		
Current assets	45,000	40,000	25,000
	180,000	80,000	35,000
Equity			
Share capital (£1 ordinary)	50,000	20,000	10,000
Retained earnings	100,000	40,000	15,000
Total equity	150,000	60,000	25,000
Liabilities	30,000	20,000	10,000
	180,000	80,000	35,000

Rik Ltd acquired its shares in Viv Ltd and Neil Ltd during the year, when their retained earnings were £4,000 and £1,000 respectively. At the end of 20X1 the goodwill impairment review revealed a loss of £3,000 in relation to the acquisition of Viv Ltd.

Requirement

Prepare the consolidated statement of financial position of Rik Ltd at 31 December 20X1.

Fill in the proforma below.

Rik Ltd: Consolidated statement of financial position as at 31 December 20X1

	£
Non-current assets	
Property, plant and equipment	
Intangible assets (W3)	
Current assets (45,000 + 40,000 + 25,000)	
Equity attributable to owners of the parent	
Called up share capital	
Retained earnings (W5)	
Non-controlling interest (W4)	
Total equity	
Liabilities (30,000 + 20,000 + 10,000)	

WORKINGS

(1) **Group structure**

(2) **Net assets**

	Year end	Acquisition	Post-acquisition
	£	£	£
Viv Ltd			
Share capital			
Retained earnings			
Neil Ltd			
Share capital			
Retained earnings			

(3) **Goodwill**

	Viv Ltd	Neil Ltd	Total
	£	£	£
Consideration transferred			

	Viv Ltd	Neil Ltd	Total
	£	£	£
Non-controlling interest at acquisition			
Viv Ltd [ ]			
Neil Ltd [ ]			
Net assets at acquisition			
Goodwill			
Impairment to date			

(4) **Non-controlling interest**

	£	£
Viv Ltd		
– Share of net assets at acquisition [ ]		
– Share of post-acquisition [ ]		
Neil Ltd		
– Share of net assets at acquisition [ ]		
– Share of post-acquisition [ ]		

(5) **Retained earnings**

	£
Rik Ltd	
Viv Ltd – Share of post-acquisition retained earnings [ ]	
Neil Ltd – Share of post-acquisition retained earnings [ ]	
Goodwill impairment to date (W3)	

See **Answer** at the end of this chapter.

3 *Acquisitions part-way through the reporting period*

Section overview

- If a subsidiary is acquired part-way through the reporting period, net assets at acquisition will need to be calculated.
- Unless told otherwise assume profits of the subsidiary accrue evenly over time.

4.1 Calculation

A parent entity is unlikely to acquire a subsidiary at the start or end of a year. If the subsidiary is acquired part-way through a reporting period (also known as 'mid-year'), it is necessary to calculate reserves, including retained earnings, at the date of acquisition.

This is necessary in order to:

- calculate net assets at acquisition (which is required as part of the goodwill calculation); and
- calculate consolidated reserves, eg, retained earnings.

Note: It is usually assumed that a subsidiary's profits **accrue evenly over time**.

Interactive question 2: Acquisition part-way through the reporting period

P plc acquired 80% of S Ltd on 31 May 20X2 for £20,000. S Ltd's retained earnings had stood at £15,000 on 1 January 20X2.

S Ltd's equity at 31 December 20X2 was as follows.

	£
Share capital	1,000
Retained earnings	15,600
Equity	16,600

Requirements

2.1 Produce the standard working for S Ltd's net assets.

WORKING

Net assets

	Year end	Acquisition	Post-acquisition
	£	£	£
Share capital			
Retained earnings			

2.2 Produce the standard working for goodwill on consolidation.

WORKING

Goodwill

	£
Consideration transferred	

£

Plus non-controlling interest at acquisition

Less net assets at acquisition (from net assets working

2.3 Calculate S Ltd's retained earnings which will be included in the consolidated retained earnings.

Fill in the proforma below.

2.3

Profit from S Ltd included in consolidated retained earnings

£

Share of post-acquisition retained earnings of S Ltd

See **Answer** at the end of this chapter.

Professional skills focus: Structuring problems and solutions

It is important to pay attention to the date of acquisition. As we have seen, if a subsidiary is acquired part-way into a reporting period, this will affect the net assets at acquisition, the goodwill calculation and the calculation of group retained earnings.

5 *Intra-group balances*

Section overview

- Group accounts reflect transactions with third parties only.
- The effects of transactions between group members should be cancelled on consolidation.
- This is an application of the single entity concept.

6.1 The single entity concept

The objective of group accounts is to present the group **as a single entity**. As a single entity cannot trade with itself, the effects of **transactions between group members** need to be **eliminated**. These transactions could be between the parent company and a subsidiary or between two subsidiaries.

A single entity also cannot owe money to itself, so any balances owed between group companies must be eliminated on consolidation.

Intra-group balances result from, for example:

- one group company's loans, debentures or redeemable preference shares held by another group company; or
- intra-group trading.

6.2 Loans, debentures and redeemable preference shares

A group company can provide a loan to another group company or can provide finance to another group company by holding its issued debentures or redeemable preference shares. These situations will give rise to an asset in one group company and a liability in another. On consolidation, we therefore need to **cancel** the **credit balance** in one company against the **debit balance** in the other.

Loans, debentures and redeemable preference shares attract interest and therefore result in a finance cost to one group company and finance income in another (which has nil net effect on retained earnings). If that interest is unpaid at year end, there will be an intra-group receivable and payable in respect of interest which also needs to be eliminated on consolidation by cancelling the debit and credit balances against each other.

6.3 Intra-group trading

Outstanding amounts in respect of intra-group trading are usually recorded in the statement of financial position in current accounts (= receivable or payable account for a fellow group company).

Step 1 Check that current accounts **agree** before cancelling. They may not agree if goods or cash are in transit at year end.

Step 2 Make the intra-group balances agree by **adjusting for items in transit** in the **receiving company's accounts**. This is normally done by pushing forward the transaction into the recipient's accounts.

Step 3 **Cancel** the intra-group balances.

Context example: Context example: Intra-group trading

Extracts from the statement of financial position of Impala Ltd and its subsidiary Springbok Ltd at 31 March 20X4 are as follows.

	Impala Ltd	Springbok Ltd
	£	£
Receivable from Springbok Ltd	25,000	–
Payable to Impala Ltd	–	(20,000)

Springbok Ltd sent a cheque for £5,000 to Impala Ltd on 28 March 20X4, which Impala Ltd did not receive until 2 April 20X4.

Step 1 **Check that current accounts agree before cancelling.**
At present, the receivable in Impala's accounts is £5,000 higher than the payable in Springbok's accounts, therefore the current accounts do not agree.

Step 2 **Make the intra-group balances agree by adjusting for items in transit in the receiving company's accounts.**
Assume that Impala Ltd had received the cash from Springbok Ltd:

	Impala Ltd	Springbok Ltd
	£	£
Receivable from Springbok Ltd (25–5)	20,000	–
Cash and cash equivalents	5,000	–
Payable to Impala Ltd	–	(20,000)

Step 3 **Cancel the intra-group balances.**
The receivable and payable of £20,000 can now be cancelled against each other, leaving just the £5,000 cash balance in the consolidated statement of financial position.

	£
Cash and cash equivalents	5,000

7 *Unrealised intra-group profit*

Section overview

- The consolidated statement of financial position should show assets at their cost to the group.
- Any profit arising on intra-group transactions should be eliminated from the group accounts until it is realised, eg, by a sale outside the group.

8.1 Introduction

One of the implications of the application of the single entity concept is that group accounts should only reflect profits generated from transactions which have been undertaken with **third parties**, ie, entities outside the group.

Intra-group activities may give rise to profits that are **unrealised** as far as the group as a whole is concerned. These profits can result from:

- **intra-group trading** when goods still held in inventory of buying company; and
- **intra-group transfers of non-current assets**.

Unrealised profits must be eliminated from the statement of financial position on consolidation to prevent the overstatement of group profits.

8.2 Inventories

As we have seen above, any receivable/payable balances outstanding between group companies, resulting from trading transactions, should be cancelled on consolidation. If these transactions have been undertaken at cost to the selling company no further problem arises.

However, each company in a group is a separate trading entity and may sell goods to another group member at a profit. **If these goods remain in inventories** at the end of the reporting period this profit is **unrealised** from the group's point of view.

In the consolidated statement of financial position, applying the **single entity concept**, inventories should be measured at the lower of cost and net realisable value **to the group**. Where goods transferred at a profit are still held at the year end the unrealised profit should be **eliminated on consolidation**. This is achieved by creating a **provision for unrealised profit (PURP).**

The way in which this adjustment is made depends on whether the company making the sale is the parent or a subsidiary.

8.2.1 Parent sells goods to a subsidiary

The required treatment is best illustrated by an example.

Context example: Context example: Intra-group profit (P->S)

Ant Ltd, a parent company, sells goods which cost £1,600 to Bee Ltd for £2,000. Ant Ltd owns 75% of the shares in Bee Ltd. Bee Ltd still hold the goods in inventories at the year end.

In the single entity accounts of Ant Ltd the profit of £400 should be recognised. In the single entity accounts of Bee Ltd the inventory should be measured at £2,000.

If we simply add together the figures for retained earnings and inventory as recorded in the individual statements of financial position of Ant Ltd and Bee Ltd, the resulting figures for consolidated retained earnings and consolidated inventory will each be overstated by £400. A consolidation adjustment is therefore necessary as follows:

		£	£
DR	Seller's (Ant Ltd's) retained earnings (ie, adjust in **retained earnings** working)	400	
CR	Inventories in consolidated statement of financial position		400

Note: In this example, as the **parent** was the seller the unrealised profit is **all 'owned' by the shareholders of Ant Ltd**. None is attributable to the **non-controlling interest**.

8.2.2 Subsidiary sells goods to parent or to another subsidiary

Where the subsidiary is the selling company the profit on the transfer will have been recorded in the subsidiary's books.

Context example: Context example: Intra-group profit (S->P or S)

Using the worked example above, if we now assume that Bee Ltd sold the goods to Ant Ltd the adjustment would be as follows:

	£	£
DR Seller's (Bee Ltd's) retained earnings (ie, adjust in **net assets** working 2)	400	
CR Inventories in consolidated statement of financial position		400

Note: The **net assets of the subsidiary making the sale at the end of the reporting period** will be reduced by the amount of the unrealised profit. Any **subsequent calculations** based on this adjusted net assets figure will therefore be affected as follows:

- The **group share** of the post-acquisition retained earnings of the subsidiary should be reduced, ie, the group will bear its share of the adjustment.
- The non-controlling interest will be based on these revised net assets ie, the non-controlling interest will bear its share of the adjustment.

Notes

Inventories in the consolidated statement of financial position should be reduced by the **full amount** of the unrealised profit **irrespective of whether the parent or a subsidiary is the selling company**. Non-controlling interest is only affected when the subsidiary is the seller.

If Bee Ltd had sold the goods to another subsidiary, rather than to the parent, the adjustment should be the same.

Interactive question 3: Unrealised profits

P Ltd owns 80% of S Ltd, which it acquired when the retained earnings of S Ltd were £20,000. No goodwill was acquired. Statements of financial position at the end of the current accounting period are as follows.

	P Ltd	**S Ltd**
	£	**£**
Assets	170,000	115,000

	P Ltd	S Ltd
	£	£
Share capital	30,000	10,000
Retained earnings	100,000	65,000
Equity	130,000	75,000
Liabilities	40,000	40,000
	170,000	115,000

During the current accounting period S Ltd sold goods to P Ltd for £18,000, which gave S Ltd a profit of £6,000. At the end of the reporting period half of these goods were included in P Ltd's inventories.

Requirement

Show how the adjustment to eliminate unrealised profits should appear in the consolidation workings for P Ltd.

Fill in the proforma below.

	£	£
DR		
CR		

WORKINGS

(1) **Group structure**

(2) **S Ltd net assets**

	Year end		Acquisition	Post-acquisition
	£	£	£	£
Share capital				
Retained earnings				
Per question				
Less PURP	-			
		-	-	

(3) **Non-controlling interest**

	£
Share of net assets at acquisition	
Share of post-acquisition (W2)	
	-

(4) **Retained earnings**

	£
P Ltd	
Share of S Ltd	
	-

See **Answer** at the end of this chapter.

8.3 Non-current asset transfers

As well as trading with each other, group companies may wish to transfer non-current assets (NCA).

If the asset is transferred at a price different from the transferor's carrying amount two issues arise:

- The selling company will have recorded **a profit or loss on sale**.
- The purchasing company will have **recorded the asset at the amount paid** to acquire it and will use that amount as the basis for calculating **depreciation**.

On consolidation, the **single entity concept** applies. The consolidated statement of financial position should show non-current assets at their **cost to the group**, and any **depreciation charged** should be based on **that cost**. In other words, the group accounts should reflect the non-current asset **as if the transfer had not been made**.

The adjustment in the consolidated statement of financial position should be calculated as follows:

	£
Carrying amount of NCA at year end in the transferee's financial statements	X
Less carrying amount of NCA at year end if transfer had not been made	(X)
Unrealised profit	X

The adjustment for unrealised profit should then be made as:

	£	£
DR Selling company retained earnings	X	
CR NCA carrying amount in consolidated statement of financial position		X

This treatment is consistent with that of inventories.

8.3.1 Parent sells non-current asset to subsidiary

As with inventories the impact of the adjustment will depend on whether the parent company or the subsidiary makes the sale.

Interactive question 4: Non-current asset transfers

P Ltd owns 80% of S Ltd. P Ltd transferred to S Ltd a non-current asset at a value of £15,000 on 1 January 20X7. The original cost to P Ltd was £20,000 and the accumulated depreciation at the date of transfer was £8,000. The asset had, and still has, a total useful life of five years.

Requirement

Calculate the consolidated statement of financial position adjustment at 31 December 20X7.

Fill in the proforma below.

Following the transfer the asset will be measured at

	£
Cost to S Ltd	
Less depreciation	

Had the transfer not been made, the asset would stand in the books at

	£
Cost	
Less: Accumulated depreciation at date of 'transfer'	
Charge for current year	

Overall adjustment in CSOFP

	£	£
DR Seller's (P Ltd's) retained earnings*		
CR Non-current assets		

(ie adjust in **retained earnings** working)

Note: In this question, as the **parent** is the selling company, **none of the adjustment is attributed to the non-controlling interest**.

See **Answer** at the end of this chapter.

8.3.2 Subsidiary sells non-current asset to parent

Again, a consolidation adjustment should be made to reflect the situation that would have existed if the transfer had not been made.

The amount of the adjustment should be calculated as before (see above).

The adjustment is then made as follows:

	£	£
DR Seller's (S Ltd) retained earnings (adjust in net assets working)	X	
CR NCA carrying amount in consolidated statement of financial position		X

Notes

As the subsidiary is the seller the **adjustment to retained earnings should be made in the net assets working**.

Any **subsequent calculations** based on this net assets figure will therefore be affected as follows:

- The **group share** of the post-acquisition retained earnings of the subsidiary will be reduced ie, as for sale of inventories.
- The **non-controlling interest** will be based on these revised net assets, ie, as for sale of inventories.

9 Fair value adjustments

Section overview

- In calculating the goodwill acquired in a business combination, the net assets of the subsidiary are measured at their fair value.
- A consolidation adjustment will be required for any difference between the carrying amount and fair value of the net assets.

10.1 Calculation of goodwill

Where a subsidiary has not reflected fair values in its single entity financial statements, adjustments will need to be made as part of the consolidation process. Goodwill should be calculated by comparing the consideration transferred and the non-controlling interest in the subsidiary with the net assets acquired. The net assets brought into this calculation should be at **fair value**, which may be different to the carrying amount in the single entity financial statements.

10.2 Reflecting fair values

The **identifiable assets and liabilities** of a subsidiary should be brought into the consolidated financial statements at their **fair value**. Normally these fair values are **not reflected** in the **single entity financial statements**. Therefore the difference between fair values and carrying amounts should be treated as a **consolidation adjustment** made only for the purposes of the consolidated financial statements.

Fair value is defined as follows by IFRS 13, *Fair Value Measurement*: 'The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Notes

If all fair values have been recognised by the acquiree, then its financial statements are suitable for the consolidation process and no adjustment is necessary.

Goodwill in the subsidiary's individual statement of financial position is **not** part of the **identifiable** assets and liabilities acquired. If the subsidiary's own statement of financial position at acquisition includes goodwill, this **should not be consolidated**. In the **net asset working** retained earnings at acquisition and at the end of the reporting period should be reduced by the amount of the goodwill.

Adjustments should be made at acquisition and may also have to be taken up in subsequent periods:

- In the consolidated statement of financial position changes will often be necessary to the acquiree's carrying amounts for non-current assets and the accumulated depreciation/ amortisation.
- In the consolidated statement of profit or loss such changes will affect the current period's depreciation/amortisation charges.

Other adjustments may have to be made, depending on the circumstances. An adjustment will always be necessary for any contingent liabilities recognised at the acquisition date, to the extent they are only disclosed by way of note in the acquiree's financial statements.

Interactive question 5: Fair value adjustments

P Ltd acquires 60% of S Ltd on 31 December 20X4 for £80,000. The statement of financial position of S Ltd at this date is as follows.

	£
Freehold land (fair value £30,000)	20,000
Goodwill arising on the acquisition of a sole trader	5,000
Sundry assets (carrying amount = fair value)	130,000

	155,000
Share capital	20,000
Retained earnings	85,000
Equity	105,000
Liabilities	50,000
	155,000

Requirement

Calculate the goodwill acquired in the business combination with S Ltd.

Fill in the proforma below.

WORKINGS

(1) **Group structure**

(2) **Net assets of S Ltd**

	Year end	= Acquisition date
	£	**£**
Share capital		
Retained earnings		
Add fair value uplift		
Less goodwill		
		110,000

(3) **Goodwill**

	£
Consideration transferred	
Non-controlling interest at acquisition	
Less FV of net assets at acquisition (net assets working)	
Goodwill	14,000

Note: In the assets section of the **consolidated statement of financial position** the freehold land should be measured at £30,000. The goodwill in the subsidiary's **statement of financial position** of £5,000 should not be separately recognised as an intangible asset in the consolidated **statement of financial position**.

See **Answer** at the end of this chapter.

Interactive question 6: Fair value adjustments

Chris Ltd acquired 60% of Andy Ltd for £8 million on 1 July 20X2 when Andy Ltd's statement of financial position showed net assets of £5 million. The fair value of Andy Ltd's property, plant and equipment with a remaining useful life of 10 years was £1 million higher than its carrying amount, but this was not reflected in Andy Ltd's books. At 30 June 20X5 Andy Ltd's statement of financial position shows net assets of £10 million. Andy Ltd's financial statements still disclose a contingent liability for a claim for damages against it. At the acquisition date its fair value was estimated at £100,000, which was its fair value until 30 June 20X5 when it was re-estimated at £80,000.

Requirement

Calculate as at 30 June 20X5 Chris Ltd's share of Andy Ltd's post-acquisition reserves, the goodwill arising on consolidation and the adjustment to be made to Andy Ltd's depreciation charge for the consolidated statement of profit or loss for the year ended 30 June 20X5.

Fill in the proforma below.

	£
Chris Ltd's share of Andy Ltd's post-acquisition reserves (W1)	
Goodwill arising on consolidation (W2)	
Adjustment to Andy Ltd's depreciation charge (W3)	

WORKINGS

(1) **Net assets and post-acquisition reserves**

	Year end	At acquisition	Post-acquisition
	£	£	£
Andy Ltd			
Net assets			
PPE fair value uplift			-
Depreciation thereon – 3 years = 30%			
Contingent liability			
Chris Ltd's share – 60%			

(2) **Goodwill**

	£
Consideration transferred	
Non-controlling interest	
Net assets (W1)	
Goodwill	

(3) **Depreciation charge**

	£
Additional charge for year ended 30 June 20X5	

Note: If future events resulted in the contingent liability ceasing to exist (eg, because it relates to a legal claim being defended and the court judgement is in favour of the defendant), it should be re-measured at £nil and the whole of the remaining £80,000 should be recognised in current period profit or loss. If future events result in the contingent liability crystallising into a liability (eg, because the court judgement is in favour of the plaintiff), no adjustment would be required to the year end net assets because the liability would be recognised by the subsidiary in its separate financial statements.

See **Answer** at the end of this chapter.

Professional skills focus: Assimilating and using information

In a consolidation question you will be faced with a lot of information. You need to evaluate the relevance of each piece of information and then use it appropriately. For example, if you are asked to prepare a consolidated statement of financial position, and you are told that the fair value of a subsidiary's property is higher than its carrying amount at acquisition – would you know the relevance of that information and how to use it? Would you know what other information you would need to determine the appropriate consolidation adjustments?

11 Other consolidation adjustments

Section overview

- If a subsidiary has reserves other than retained earnings, the group share of post-acquisition reserves should be consolidated.
- The balances of the subsidiary should be adjusted to reflect the accounting policies of the parent company before consolidation.

12.1 Other reserves in a subsidiary

A subsidiary may have other reserves apart from retained earnings in its statement of financial position, eg, a revaluation surplus. If this is the case, such reserves should be treated in exactly the same way as retained earnings.

- **Other reserves at acquisition** form part of the **net assets at acquisition**, ie, they should be recorded in the net assets working at acquisition.
- The **group share of any post acquisition** movement in other reserves should be **recognised** in the consolidated statement of financial position.

Notes

A **separate working** should be used for **each reserve**; do not mix retained earnings with other reserves as the other reserves may include amounts which are not distributable by way of dividend.

If a subsidiary is **loss-making or has any other negative reserves** the group should consolidate its share of the **post-acquisition losses/negative reserves**.

12.2 Accounting policy alignments

On consolidation **uniform accounting policies should be applied for all amounts**. This is another consequence of the **single entity concept**.

If the parent company and subsidiary have different accounting policies the balances in **the subsidiary's financial statements** should be adjusted **to reflect the accounting policies of the parent company**.

Note: These adjustments are made in the **net assets working**.

Interactive question 7: Accounting policy alignments

William Ltd has been 85% owned by Mary Ltd for some years. On 1 January 20X4 William Ltd acquired an investment property for £2,000,000 and elected to apply the cost model, depreciating over 50 years. Therefore, the carrying amount at year end was £1,960,000. Group policy is to use the fair value model, and the fair value of property at the year end is £2,150,000 .

Requirement

Set out the adjustment required in the preparation of the consolidated statement of financial position at 31 December 20X5.

Fill in the proforma below.

Under the fair value model, no depreciation is charged and the fair value of the asset is assessed at each period end date with the gain or loss recognised in profit or loss (retained earnings). As the investment property is held by the subsidiary, non-controlling interest is allocated its share of the change in retained earnings. The calculation and journal entry required are as follows:

	£
Carrying amount of investment property at fair value	
Carrying amount in William Ltd's SOFP	
Increase in carrying amount	

	£	£
DR Investment property		
CR Consolidated retained earnings (85%)		
CR Non-controlling interest (15%)		

See **Answer** at the end of this chapter.

13 *UK GAAP comparison*

Section overview

There are some important differences between FRS 102 and IFRS.

14.1 Consolidated financial statements

Non-controlling interest

FRS 102	IFRS
Non-controlling interest is always measured at its share of net assets.	IFRS 3 allows non-controlling interest to be measured at fair value or its share of the fair value of net assets.

Acquisition related costs

FRS 102	IFRS
Acquisition-related costs are added to the cost of the investment in the subsidiary and increase the measurement of goodwill.	Acquisition-related costs are recognised as an expense in profit or loss as incurred.

Contingent consideration

FRS 102	IFRS
A reasonable estimate of the fair value of the amounts payable as contingent consideration (discounted where appropriate) is added to the cost of the investment at the acquisition date, **where it is probable that the amount will be paid and it can be measured reliably**. Where the amount was not probable or could not be reliably measured, but is now probable and can be measured reliably, the additional consideration should be related back to the acquisition date, increasing or decreasing goodwill.	At the acquisition date the fair value of contingent consideration is recognised as part of the consideration transferred. If subsequent adjustments to this fair value occur **within** the measurement period **and** are as a result of additional information about facts or circumstances at the acquisition date, those adjustments are related back to the acquisition date, increasing or decreasing goodwill. However, if subsequent adjustments to this fair value occur either: •

FRS 102	IFRS
Any changes to the estimate of the contingent consideration outside of the 12 month period should be accounted for in accordance with FRS 102 Section 10 *Accounting Policies, Estimates and Errors* as a change in accounting estimate and therefore recognised prospectively by including the adjustment in the profit and loss account. There is no specific requirement to reassess to fair value at each year end.	• **within** the measurement period, but are **not** as a result of additional information about facts or circumstances at the acquisition date; or • are **outside** the measurement period, they are **not related back** to the acquisition date but are recognised as an expense in profit or loss. They do not increase or decrease goodwill. Measurement of the contingent consideration should be reassessed at fair value each year and the difference taken to profit or loss unless the contingent consideration is in shares (ie, classified as equity) then it should be remeasured but its subsequent settlement should instead be recognised as part of equity.

Goodwill amortisation

FRS 102	IFRS
Goodwill is **amortised over its estimated useful economic life**. If this cannot be reliably estimated it should not be more than 10 years. Impairment reviews are required where evidence of impairment arises.	IFRS 3 **prohibits amortisation** of goodwill and requires annual impairment reviews.

Negative goodwill (gain on a bargain purchase)

FRS 102	IFRS
Negative goodwill is recognised as a separate asset in the CSOFP. Negative goodwill up to the fair values of the non-monetary assets acquired should be recognised in the profit and loss account in the periods in which the non-monetary assets are recovered, whether through depreciation or sale.	IFRS 3 requires **immediate recognition as a gain in profit or loss**.

Exclusion of subsidiary from consolidation

FRS 102	IFRS
A subsidiary should be excluded from consolidation if severe long-term restrictions prevent the parent exercising control.	No such exemption on this basis exists under IFRS 10 (although control may be lost as a result of the restrictions, such that the entity should no longer be classified as a subsidiary).

Worked example: UK GAAP and IFRS

On 31 December 20X7 Magnate plc acquired 90% of the equity of Tycoon Ltd for a cash payment of £5 million. At that date the fair value of the 10% of the equity not acquired was £380,000.

Magnate plc incurred external professional fees in respect of this acquisition of £250,000 and estimated that the amount chargeable to the business combination in respect of the staff who worked on it was £200,000.

At 31 December 20X7 the carrying amount of the net assets recognised by Tycoon Ltd was £2.8 million, which approximated to their fair value. In addition Magnate plc identified the following:

- A trademark developed by Tycoon Ltd which at the acquisition date had a fair value of £400,000 and a useful life of four years

Magnate plc adopts the following accounting policies:

- To measure the non-controlling interest at the acquisition date at fair value, where this is permitted
- To amortise goodwill over five years, where amortisation is permitted

Requirement

Calculate under UK GAAP and IFRS the goodwill acquired in the business combination on 31 December 20X7.

Solution

The goodwill acquired in the business combination on 31 December 20X7

	UK GAAP	IFRS
	£	£
Cost of investment/consideration transferred	5,000,000	5,000,000
External acquisition costs (Note 1)	250,000	–
Non-controlling interest at fair value	–	380,000
	5,250,000	5,380,000
Net assets recognised (UK = 90% × 2,800,000)	(2,520,000)	(2,800,000)
Trademark (Note 2) (UK = 90% × 400,000)	(360,000)	(400,000)
Goodwill (Note 3)	2,370,000	2,180,000

Notes

Both UK GAAP and IFRS require internal acquisition costs to be recognised as an expense as incurred. UK GAAP requires external costs to be added to the cost of the investment in the subsidiary, but IFRS require them to be recognised as an expense as incurred.

Both UK GAAP and IFRS require the recognition of the trademark as an acquired intangible, because it is separable.

UK GAAP requires the amortisation of goodwill, while IFRS prohibits it. Both require goodwill to be tested for impairment.

Professional skills focus: Concluding, recommending and communicating

The treatment of some aspects of group accounting are very different under UK GAAP than they are under IFRS. It is important that you can clearly communicate the different accounting requirements and present the ultimate effect of those differences, in a manner that is understandable to the audience you are explaining to.

Summary

!! Error resolving referred content !!

Further question practice

1 Knowledge diagnostic

Before you move on to question practice, complete the following knowledge diagnostic and check you are able to confirm you possess the following essential learning from this chapter. It not, you are advised to revisit the relevant learning from the topic indicated.

Confirm your learning	
1.	Can you write out the standard workings for the consolidated statement of financial position? (Topic 1)
2.	Why does it matter to know the date on which a subsidiary was acquired? What if the acquisition wasn't on the first day of the reporting period? (Topic 2)
3.	If group companies trade with each other, what consolidation adjustments are likely to be needed? (Topics 3 and 4)
4.	If the fair value of a subsidiary's net assets is higher than their carrying amount at acquisition, can you explain what consolidation adjustments would be necessary? (Topic 4)
5.	Can you explain the key differences between UK GAAP and IFRS for the preparation of a consolidated statement of financial position? (Topic 6)

2 Question practice

Aim to complete all self-test questions at the end of this chapter. The following self-test questions are particularly helpful to further topic understanding and guide skills application before you proceed to the next chapter.

Question	Learning benefit from attempting this question
VW plc	This question asks you to prepare several extracts from the consolidated financial statements, so it is a great question to test whether you have understood those individual bits of consolidation, aside from preparing the full consolidated statement.
Close Ltd	Part (a) of this question requires the preparation of a full consolidated statement of financial position, with lots of consolidation adjustments thrown in. It is great for practising the different topics covered in this chapter. Part (b) requires you to explain the adjustments required in respect of intra-group trading. Being asked to explain something is a great way to test whether you have fully grasped it.

Once you have completed these self-test questions, it is beneficial to attempt the following questions from the Question Bank for this module. These questions have been selected to introduce exam style scenarios that will help you improve your knowledge application and professional skills development before you start the next chapter.

Question	Learning benefit from attempting this question
Laois plc, part 37.2 only (5 marks)	This part of the question tests whether you can explain the two different methods of measuring non-controlling interest under IFRS 3, with reference to an acquisition given in the scenario. The scenario includes a fair value adjustment. This question a good test of your ability to explain the principles and calculate both goodwill and non-controlling interests.

Frogmette plc, part 47.1 (issues 1 and 2 only – 11.5 marks) and part 47.4 (3 marks)	Part 47.1 issues 1 and 2 concern the acquisition of a subsidiary and test whether you can explain how to account for a contingent consideration and determine the accounting treatment of a previously unrecognised intangible asset. Part 47.4 requires you to explain the differences in accounting for these issues under UK GAAP. This is a good question to test your understanding of some of the topics covered in Chapters 10 and 11, as well as applying knowledge of UK GAAP gained in this chapter.
Advent plc, part 48.1 (issue 1 only – 11 marks)	This question tests a many off the topics covered in this chapter and Chapter 10 – control, fair value of consideration and calculating goodwill. It is also a mid-year acquisition. It is a bit tricky, but a good test of how much you have understood and whether you can explain and apply that knowledge.

Refer back to the learning in this chapter for any questions which you did not answer correctly or where the suggested solution has not provided sufficient explanation to answer all your queries. Once you have attempted these questions, you can continue your studies by moving on to the next chapter.

Technical reference

For a comprehensive Technical reference section, covering all aspects of group accounts (except group statements of cash flows) see Chapter 10.

Self-test questions

Answer the following questions.

1 Black plc

The summarised statements of financial position of Black plc and Red plc at 31 December 20X6 were as follows.

	Black plc	Red plc
	£	£
Total assets	60,000,000	29,000,000
Share capital	20,000,000	10,000,000
Retained earnings	24,000,000	4,000,000
Equity	44,000,000	14,000,000
Current liabilities	16,000,000	15,000,000
Total equity and liabilities	60,000,000	29,000,000

On 1 January 20X7 Black plc bought all the share capital of Red plc for £17,000,000 in cash. The carrying amounts of Red plc's assets are considered to be fair values.

Requirement

What will be the amount of retained earnings to be included in the consolidated statement of financial position as at 1 January 20X7?

2 Milton plc

Milton plc owns all the share capital of Keynes Ltd. The following information is extracted from the individual company statements of financial position as on 31 December 20X1.

	Milton plc	Keynes Ltd
	£	£
Current assets	500,000	200,000
Current liabilities	220,000	90,000

Included in Milton plc's purchase ledger is a balance in respect of Keynes Ltd of £20,000. The balance on Milton plc's account in the sales ledger of Keynes Ltd is £22,000. The difference between those figures is accounted for by cash in transit.

Requirement

If there are no other intra-group balances, what is the amount of current assets less current liabilities in the consolidated statement of financial position of Milton plc and its subsidiary?

3 Laker Ltd

Laker Ltd owns 80% of the ordinary shares of Hammond Ltd. The following amounts have been extracted from their draft financial statements at 31 December 20X0.

	Laker Ltd	Hammond Ltd
	£	£
Current liabilities		
Trade payables	5,200	7,100
Amount owed to subsidiary	500	–
Income tax	100	150
Amounts owed to trade investments	150	200
Other payables	50	70
	6,000	7,520

Hammond Ltd shows an amount receivable from Laker Ltd of £620 and the difference is due to cash in transit.

Requirement

What is the total carrying amount of current liabilities in the consolidated statement of financial position of Laker Ltd?

4 Austen plc

Austen plc has owned 100% of Kipling Ltd and 60% of Dickens Ltd for many years. At 31 December 20X5 the trade receivables and trade payables shown in the individual company statements of financial position were as follows.

	Austen plc	Kipling Ltd	Dickens Ltd
	£	£	£
Trade receivables	50,000	30,000	40,000
Trade payables	30,000	15,000	20,000
Trade payables are made up as follows:			
Amounts owing to			
Austen	–	–	–
Kipling	2,000	–	4,000
Dickens	3,000	–	–
Other suppliers	25,000	15,000	16,000
	30,000	15,000	20,000

The intra-group accounts agreed after taking into account the following.

(1) An invoice for £3,000 posted by Kipling Ltd on 31 December 20X5 was not received by Austen plc until 2 January 20X6.

(2) A cheque for £2,000 posted by Austen plc on 30 December 20X5 was not received by Dickens Ltd until 4 January 20X6.

Requirement

What amount should be shown as trade receivables in the consolidated statement of financial position of Austen plc?

5 Ho plc

The following is the draft statement of financial position information of Ho plc and Su Ltd, as on 30 September 20X2.

	Ho plc	Su Ltd
	£	£
Ordinary £1 shares	2,600,000	1,000,000
Retained earnings	750,000	700,000
Trade payables	350,000	900,000
Other payables	–	100,000
	3,700,000	2,700,000
Total assets	3,700,000	2,700,000

Ho plc acquired 60% of the share capital of Su Ltd several years ago when Su Ltd's retained earnings were £300,000. Su Ltd has not yet accounted for the estimated audit fee for the year ended 30 September 20X2 of £40,000.

Requirement

What should the amount of consolidated retained earnings be on 30 September 20X2?

6 Oxford Ltd

Oxford Ltd owns 100% of the issued share capital of Cambridge Ltd, and sells goods to its subsidiary at a profit margin of 20%. At the year end their statements of financial position showed inventories of

Oxford Ltd	£290,000
Cambridge Ltd	£160,000

The inventory of Cambridge Ltd included £40,000 of goods supplied by Oxford Ltd and there was inventory in transit from Oxford to Cambridge amounting to a further £20,000.

Requirement

At what amount should inventory be carried in the consolidated statement of financial position?

7 Rugby Lt

Rugby Ltd has a 75% subsidiary, Stafford Ltd, and is preparing its consolidated statement of financial position as on 31 December 20X6. The carrying amount of property, plant and equipment in the two companies at that date is as follows.

Rugby Ltd – £260,000

Stafford Ltd – £80,000

On 1 January 20X6 Stafford Ltd had transferred some equipment to Rugby Ltd for £40,000. At the date of transfer the equipment, which had cost £42,000, had a carrying amount of £30,000 and a remaining useful life of five years. The group accounting policy is to depreciate equipment on a straight-line basis down to a nil residual value.

Requirement

What figure should be disclosed as the carrying amount of property, plant and equipment in the consolidated statement of financial position of Rugby Ltd as on 31 December 20X6?

8 Lynton Ltd

Lynton Ltd acquired 75% of the 200,000 £1 ordinary shares and 50% of the 100,000 £1 redeemable preference shares of Pinner Ltd when its retained earnings were £24,000. The retained earnings of Lynton Ltd and Pinner Ltd are now £500,000 and £60,000 respectively.

Requirement

What figures for non-controlling interest and consolidated retained earnings should be included in the current consolidated statement of financial position?

9 Hill plc

Hill plc owns 60% of the ordinary share capital of Down plc and all of its 10% borrowings. The following transactions have been recorded by Down plc as at 31 December 20X3.

Half year's interest due :£15,000

Interim dividend paid :£50,000

Hill plc has not yet accounted for the interest receivable from Down plc.

Requirement

In preparing the consolidated statement of financial position for Hill plc and its subsidiary at 31 December 20X3, what adjustments are required in respect of intra-group dividends and debenture interest?

10 Nasty Ltd

Nasty Ltd and Horrid Ltd are wholly-owned subsidiaries of Ugly Ltd. Inventory in their individual statements of financial position at the year end is shown as follows.

Ugly Ltd : £30,000

Horrid Ltd :£10,000

Nasty Ltd: £20,000

Sales by Horrid Ltd to Nasty Ltd during the year were invoiced at £15,000, which included a profit to Horrid Ltd of 25% on cost. Two thirds of these goods were in inventory at the year end.

Requirement

At what amount should inventory appear in the consolidated statement of financial position?

11 Fallin Ltd

Fallin Ltd acquired 100% of the share capital of Gaydon Ltd for £150,000 on 1 May 20X6. Equity at 30 April was as follows.

	Fallin Ltd	**Gaydon Ltd**	
	20X7	**20X7**	**20X6**
	£	**£**	**£**
Ordinary share capital	100,000	50,000	50,000
Revaluation surplus	–	25,000	15,000
Retained earnings	340,000	135,000	25,000
	440,000	210,000	90,000

An impairment review at 30 April 20X7 revealed that goodwill acquired in the business combination with Gaydon Ltd had become impaired by £6,000 in the year.

Requirement

What should the consolidated equity of the Fallin Ltd group be on 30 April 20X7?

12 VW plc

With reference to the information below, answer the requirements with respect to the consolidated financial statements of VW plc.

Summarised statements of financial positionas at 30 September 20X7

	VW plc	Polo Ltd	Golf Ltd
	£	£	£
ASSETS			
Property, plant and equipment	200,000	40,000	30,000
Investments			
100,000 shares in Polo Ltd	150,000	–	–
40,000 shares in Golf Ltd	70,000	–	–
Current assets			
Inventories	150,000	90,000	80,000
Trade receivables	250,000	40,000	20,000
Cash	50,000	20,000	10,000
	870,000	190,000	140,000
EQUITY AND LIABILITIES			
Equity			
Ordinary shares of £1 each	500,000	100,000	50,000
Retained earnings	90,000	40,000	70,000
Total equity	590,000	140,000	120,000
Current liabilities	280,000	50,000	20,000
	870,000	190,000	140,000

Notes

VW plc acquired its shares in Polo Ltd on 1 October 20X5 when Polo Ltd's retained earnings were £30,000.

VW plc acquired its shares in Golf Ltd on 30 September 20X6. Golf Ltd's net profit for the year ended 30 September 20X7 was £30,000.

It is the policy of the VW group to measure goodwill and the non-controlling interest using the proportionate basis.

Included in Polo Ltd's inventory at 30 September 20X7 was £15,000 of goods purchased from VW plc during the year. VW plc invoiced Polo Ltd at cost plus 50%.

During the year ended 30 September 20X7 Polo Ltd sold goods costing £50,000 to Golf Ltd for £70,000. Golf Ltd still had half of these goods in inventory at 30 September 20X7.

The following intra-group balances are reflected in the above statement of financial position of VW plc at 30 September 20X7.

£20,000 receivable from Polo Ltd

£10,000 payable to Golf Ltd

Requirements

12.1 What should the amount of non-controlling interest be?

12.2 What is the total of group inventories

12.3 What is group trade receivables?

12.4 What amount of goodwill should be included under intangible assets?

12.5 Consolidated retained earnings should be presented at what amount?

13 Dublin Ltd

The following are the summarised statements of financial position of a group of companies as at 31 December 20X9.

	Dublin Ltd	Shannon Ltd	Belfast Ltd
	£	£	£
ASSETS			
Non-current assets			
Property, plant and equipment	90,000	60,000	50,000
Investments: 40,000 £1 shares in Shannon	50,000	–	–
12,000 6% loan notes of Shannon	12,000		
30,000 £1 shares in Belfast	45,000	–	–
	197,000	60,000	50,000
Current assets	203,000	70,000	30,000
Total assets	400,000	130,000	80,000
EQUITY AND LIABILITIES			
Equity			
Ordinary share capital	190,000	50,000	40,000
Revaluation surplus	–	10,000	–
Retained earnings	60,000	30,000	16,000
Total equity	250,000	90,000	56,000
Non-current liabilities – loan notes	-	20,000	-
Current liabilities	150,000	20,000	24,000
Total equity and liabilities	400,000	130,000	80,000

Dublin Ltd purchased its shares and loan notes in Shannon Ltd five years ago when there were retained earnings of £20,000 and a balance on its revaluation surplus of £10,000.

Belfast Ltd had retained earnings of £16,000 when Dublin Ltd acquired its shares on 1 January 20X9.

At the end of 20X9 the goodwill impairment review revealed a loss of £300 in relation to the goodwill acquired in the business combination with Belfast Ltd.

During November 20X9, Shannon Ltd had sold goods to Belfast Ltd for £12,000 at a mark-up on cost of 20%. Half of these goods were still held by Belfast Ltd at 31 December 20X9.

Dublin Ltd prefers to measure goodwill and the non-controlling interest using the proportionate method wherever possible.

Requirement

Prepare the consolidated statement of financial position as at 31 December 20X9 of Dublin Ltd and its subsidiaries.

Total: 12 marks

14 Close Ltd

The summarised statements of financial position of Close Ltd and Steele Ltd as at 31 December 20X9 were as follows.

	Close Ltd		Steele Ltd	
	£	£	£	£
ASSETS				
Non-current assets				
Property, plant and equipment		80,000		58,200
Investments		84,000		–
		164,000		58,200
Current assets				
Inventories	18,000		12,000	
Trade and other receivables	62,700		21,100	
Investments	–		2,500	
Cash and cash equivalents	10,000		3,000	
Current account – Close Ltd	–		3,200	
		90,700		41,800
Total assets		254,700		100,000
EQUITY AND LIABILITIES				
Equity				
Ordinary share capital (£1 shares)		120,000		60,000
Share premium account		18,000		–
Revaluation surplus		23,000		16,000
Retained earnings		56,000		13,000
Total equity		217,000		89,000
Current liabilities				
Trade and other payables	35,000		11,000	
Current account – Steele Ltd	2,700		–	
		37,700		11,000
Total equity and liabilities		254,700		100,000

The following information is relevant.

(1) On 1 January 20X7 Close Ltd acquired 48,000 shares in Steele Ltd for £84,000 cash when the retained earnings of Steele Ltd were £8,000 and the balance on the revaluation surplus was £16,000.

(2) At the acquisition date Steele Ltd disclosed a contingent liability as a potential £300,000, although its fair value was assessed at £58,000. A final decision on this matter is expected to be reached within the next 12 months.

(3) The inventories of Close Ltd include £4,000 of goods from Steele Ltd invoiced to Close Ltd at cost plus 25%.

(4) A cheque for £500 from Close Ltd to Steele Ltd, sent before 31 December 20X9, was not received by the latter company until January 20Y0.

(5) An impairment review at 31 December 20X9 revealed that an impairment loss of £500 in respect of goodwill on the acquisition of Steele Ltd needs to be recognised. By 1 January 20X9 this goodwill had already suffered impairments totalling £1,700.

(6) The non-controlling interest and goodwill arising on the acquisition of Steele Ltd were both calculated using the proportionate method.

Requirements

14.1 Prepare the consolidated statement of financial position of Close Ltd and its subsidiary Steele Ltd as at 31 December 20X9.

14.2 Explain the adjustments necessary in respect of intra-group sales when preparing the consolidated statement of financial position of the Close Ltd group.

Total: 18 marks

Now go back to the Introduction and ensure that you have achieved the Learning outcomes listed for this chapter.

Answers to Interactive questions

Answer to Interactive question 1

Rik Ltd: Consolidated statement of financial position as at 31 December 20X1

	£
Non-current assets	
Property, plant and equipment (100,000 + 40,000 + 10,000)	150,000
Intangible assets (W3)	6,667
	156,667
Current assets (45,000 + 40,000 + 25,000)	110,000
	266,667
Equity attributable to owners of the parent	
Called up share capital	50,000
Retained earnings (W5)	133,334
	183,334
Non-controlling interest (W4)	23,333
Total equity	206,667
Liabilities (30,000 + 20,000 + 10,000)	60,000
	266,667

WORKINGS

(1) **Group structure**

(2) **Net assets**

	Year end	Acquisition	Post-acquisition
	£	£	£
Viv Ltd			
Share capital	20,000	20,000	–
Retained earnings	40,000	4,000	36,000
	60,000	24,000	
Neil Ltd			
Share capital	10,000	10,000	–
Retained earnings	15,000	1,000	14,000
	25,000	11,000	

(3) **Goodwill**

	Viv Ltd	Neil Ltd	Total
	£	**£**	**£**
Consideration transferred	25,000	10,000	
Non-controlling interest at acquisition			
Viv Ltd (25% × 24,000 (W2))	6,000		
Neil Ltd (1/3 × 11,000 (W2))		3,667	
Net assets at acquisition	(24,000)	(11,000)	
Goodwill	7,000	2,667	9,667
Impairment to date	(3,000)	–	(3,000)
	4,000	2,667	6,667

(4) **Non-controlling interest**

	£	£
Viv Ltd		
– Share of net assets at acquisition (25% × 24,000 (W2))	6,000	
– Share of post-acquisition (25% × 36,000 (W2))	9,000	
		15,000
Neil Ltd		
– Share of net assets at acquisition (1/3 × 11,000 (W2))	3,667	
– Share of post-acquisition (1/3 × 14,000 (W2))	4,666	
		8,333
		23,333

(5) **Retained earnings**

	£
Rik Ltd	100,000
Viv Ltd – Share of post-acquisition retained earnings (75% × 36,000 (W2))	27,000
Neil Ltd – Share of post-acquisition retained earnings (2/3 × 14,000 (W2))	9,334
Goodwill impairment to date (W3)	(3,000)
	133,334

Answer to Interactive question 2

WORKING

Net assets

	Year end	Acquisition	Post-acquisition
	£	£	£
Share capital	1,000	1,000	–
Retained earnings (15,000 + (5/12 × (15,600 – 15,000)))	15,600	15,250	350
	16,600	16,250	

WORKING

Goodwill

	£
Consideration transferred	20,000
Plus non-controlling interest at acquisition (16,250 (from net assets working) × 20%)	3,250
Less net assets at acquisition (from net assets working	(16,250)
	7,000

2.3

Profit from S Ltd included in consolidated retained earnings

	£
Share of post-acquisition retained earnings of S Ltd (80% × 350 (from net assets working))	280

Answer to Interactive question 3

	£	£
DR Seller's (S Ltd's) retained earnings (adjust in net assets working)	3,000	
CR Inventories in CSOFP (1/2 × 6,000)		3,000

WORKINGS

(1) **Group structure**

(2) **S Ltd net assets**

	Year end		Acquisition	Post-acquisition
	£	£	£	£
Share capital		10,000	10,000	
Retained earnings				
Per question	65,000			

	Year end		Acquisition	Post-acquisition
	£	£	£	£
Less PURP	(3,000)			
		62,000	20,000	42,000
		72,000	30,000	

(3) **Non-controlling interest**

		£
Share of net assets at acquisition	(20% × 30,000)	6,000
Share of post-acquisition (W2)	(20% × 42,000)	8,400
		14,400

(4) **Retained earnings**

	£
P Ltd	100,000
Share of S Ltd (80% × 42,000 (W2))	33,600
	133,600

Answer to Interactive question 4

Following the transfer the asset will be measured at

	£
Cost to S Ltd	15,000
Less depreciation (15,000/3 remaining years (8,000 is 2/5 of cost))	(5,000)
	10,000

Had the transfer not been made, the asset would stand in the books at

	£
Cost	20,000
Less: Accumulated depreciation at date of 'transfer'	(8,000)
Charge for current year (£20,000/5)	(4,000)
	8,000

Overall adjustment in CSOFP

	£	£
DR Seller's (P Ltd's) retained earnings*	2,000	
CR Non-current assets		2,000

(ie adjust in **retained earnings** working)

Note: In this question, as the **parent** is the selling company, **none of the adjustment is attributed to the non-controlling interest**.

Answer to Interactive question 5

WORKINGS

(1) **Group structure**

(2) **Net assets of S Ltd**

	Year end = Acquisition date	
	£	£
Share capital		20,000
Retained earnings	85,000	
Add fair value uplift (30,000 – 20,000)	10,000	
Less goodwill	(5,000)	
		90,000
		110,000

(3) **Goodwill**

	£
Consideration transferred	80,000
Non-controlling interest at acquisition (40% × 110,000 (et asnsets working))	44,000
Less FV of net assets at acquisition (net assets working)	(110,000)
Goodwill	14,000

Note: In the assets section of the **consolidated statement of financial position** the freehold land should be measured at £30,000. The goodwill in the subsidiary's **statement of financial position** of £5,000 should not be separately recognised as an intangible asset in the consolidated **statement of financial position**.

Answer to Interactive question 6

	£
Chris Ltd's share of Andy Ltd's post-acquisition reserves (W1)	2,832,000
Goodwill arising on consolidation (W2)	4,460,000
Adjustment to Andy Ltd's depreciation charge (W3)	100,000

WORKINGS

(1) **Net assets and post-acquisition reserves**

	Year end	At acquisition	Post-acquisition
	£	£	£
Andy Ltd			
Net assets	10,000,000	5,000,000	5,000,000

	Year end	At acquisition	Post-acquisition
PPE fair value uplift	1,000,000	1,000,000	-
Depreciation thereon – 3 years = 30%	(300,000)	–	(300,000)
Contingent liability	(80,000)	(100,000)	20,000
	10,620,000	5,900,000	4,720,000
Chris Ltd's share – 60%			2,832,000

(2) **Goodwill**

	£
Consideration transferred	8,000,000
Non-controlling interest (40% × 5,900,000 (W1))	2,360,000
Net assets (W1)	(5,900,000)
Goodwill	4,460,000

(3) **Depreciation charge**

	£
Additional charge for year ended 30 June 20X5 (10% × 1,000,000)	100,000

Note: If future events resulted in the contingent liability ceasing to exist (eg, because it relates to a legal claim being defended and the court judgement is in favour of the defendant), it should be re-measured at £nil and the whole of the remaining £80,000 should be recognised in current period profit or loss. If future events result in the contingent liability crystallising into a liability (eg, because the court judgement is in favour of the plaintiff), no adjustment would be required to the year end net assets because the liability would be recognised by the subsidiary in its separate financial statements.

Answer to Interactive question 7

Under the fair value model, no depreciation is charged and the fair value of the asset is assessed at each period end date with the gain or loss recognised in profit or loss (retained earnings). As the investment property is held by the subsidiary, non-controlling interest is allocated its share of the change in retained earnings. The calculation and journal entry required are as follows:

Add back the depreciation charged and reflect the fair value at the period end.

	£
Carrying amount of investment property at fair value	2,150,000
Carrying amount in William Ltd's SOFP	1,960,000
Increase in carrying amount	190,000

The journal entry required on consolidation is as follows

	£	£
DR Investment property	190,000	
CR Consolidated retained earnings (85%)		161,500
CR Non-controlling interest (15%)		28,500

Answers to Self-test questions

1 Black plc

	£
Retained earnings – Black plc only	24,000,000

No post-acquisition profits have yet arisen in Red plc.

2 Milton plc

	Milton	Keynes	Adjustment	Consolidated
	£	£	£	£
Current assets	500,000	200,000	–22,000 + 2,000	680,000
Current liabilities	(220,000)	(90,000)	+20,000	(290,000)
	280,000	110,000		390,000

3 Laker Ltd

	£
Laker	6,000
Hammond	7,520
Less intra-group indebtedness	(500)
Total current liabilities	13,020

4 Austen plc

	£	£
Austen plc		50,000
Kipling Ltd		30,000
Dickens Ltd	40,000	
Less cash in transit	(2,000)	
		38,000
		118,000
Less intra-group receivables		
Owed to Kipling Ltd (2,000 + 3,000 + 4,000)	9,000	
Owed to Dickens Ltd	3,000	
		(12,000)

Group trade receivables		106,000

5 Ho plc

	£
Ho plc	750,000
Su Ltd – Ho plc's share of post-acquisition retained earnings	
(60% × ×(700 – 40) – 300))	216,000
Consolidated retained earnings	966,000

6 Oxford Ltd

	£
Oxford Ltd	290,000
Cambridge Ltd	160,000
In transit to Cambridge Ltd	20,000
Less PURP ((40,000 + 20,000) × 20%)	(12,000)
Group inventory	458,000

7 Rugby Lt

The adjustment required following the intragroup transfer is £8,000.

	Is	**Should be**
	£	**£**
Cost	40,000	42,000
Accumulated depreciation	(8,000)	(18,000)
Carrying amount	32,000	24,000

Adjustment required:

	£	£
DR Stafford Ltd retained earnings	8,000	
CR Property, plant and equipment		8,000

PPE in consolidated statement of financial position = 260,000 + 80,000 – 8,000 = £332,000

8 Lynton Ltd

	£
Non-controlling interest	
Ordinary shares (25% × (200,000 + 60,000))	65,000

Consolidated retained earnings	
Lynton Ltd	500,000
Pinner Ltd (75% × (60,000 – 24,000))	27,000
	527,000

Note: Redeemable preference shares should be classified as liabilities.

9 Hill plc

Adjustments required:

(1) To account for the interest receivable by Hill plc

	£	£
DR Current assets in Hill with interest receivable	15,000	
CR Retained earnings of Hill		15,000

(2) To cancel intra-group balances for interest

	£	£
DR Current liabilities in Down	15,000	
CR Current assets in Hill		15,000

Note: there will be no outstanding balances for the dividends as they have been paid and would not be included as payables even if unpaid.

Summary of adjustment required:

	£	£
DR Current liabilities	15,000	
CR Retained earnings of Hill		15,000

10 Nasty Ltd

	£
Ugly Ltd	30,000
Nasty Ltd	20,000
Horrid Ltd	10,000
Less PURP ($^2/_3 \times 15{,}000 \times {}^{25}/_{125}$)	(2,000)
Group inventory	58,000

11 Fallin Ltd

	£	£

Ordinary share capital		100,000
Revaluation surplus (25 – 15)		10,000
Retained earnings		
Fallin Ltd	340,000	
Gaydon Ltd (135 – 25)	110,000	
Goodwill impairment to date	(6,000)	
		444,000
Group equity		554,000

12 VW plc

12.1

Non-controlling interest = 20% × (50,000 + 70,000) = £24,000

12.2

	£
VW plc	150,000
Polo Ltd	90,000
Golf Ltd	80,000
	320,000
Less PURP	
Note (3) (15,000 × $^{50}/_{150}$ in VW plc's retained earnings)	(5,000)
Note (4) (1/2 × 70,000 – 50,000 in Polo Ltd's retained earnings)	(10,000)
Group inventories	305,000

12.3

	£
VW plc	250,000
Less intra-group receivable	(20,000)
Polo Ltd	40,000
Golf Ltd	20,000
Less intra-group receivable	(10,000)
Group trade receivables	280,000

12.4

	£	£
Polo – consideration transferred		150,000
Net assets		

Share capital	100,000	
Retained earnings at acquisition	30,000	
		(130,000)
Goodwill		20,000
Golf – consideration transferred		70,000
Non-controlling interest at acquisition (90,000 (below) × 20%)		18,000
		88,000
Net assets at acquisition		
Share capital	50,000	
Retained earnings (70 – 30)	40,000	
		(90,000)
Gain on a bargain purchase		(2,000)
Recognised in consolidated statement of profit or loss in period of acquisition		

12.5

	£
VW plc	90,000
Less PURP per 13 above	(5,000)
	85,000
Polo Ltd ((40,000 – 10,000 PURP per 13 above) – 30,000)	–
Golf Ltd (80% × 30,000)	24,000
Gain on bargain purchase of Golf Ltd	2,000
Consolidated retained earnings	111,000

13 Dublin Ltd

Consolidated statement of financial position as at 31 December 20X9

	£
ASSETS	
Non-current assets	
Property, plant and equipment (90,000 + 60,000 + 50,000)	200,000
Intangibles (W3)	2,700
	202,700
Current assets (203,000 + 70,000 + 30,000 – 1,000 (W6))	302,000
Total assets	504,700
EQUITY AND LIABILITIES	

	£
Equity attributable to owners of the parent	
Ordinary share capital	190,000
Retained earnings (W5)	80,900
	270,900
Non-controlling interest (W4)	31,800
Total equity	302,700
Non-current liabilities (loan notes 20,000 – 12,000)	8,000
Current liabilities (150,000 + 20,000 + 24,000)	194,000
Total equity and liabilities	504,700

WORKINGS

(1) **Group structure**

(2) **Net assets**

	Year end	**Acquisition date**	**Post-acquisition**
Shannon Ltd	**£**	**£**	**£**
Share capital	50,000	50,000	–
Revaluation surplus	10,000	10,000	–
Retained earnings (30,000 – 1,000 (W6))	29,000	20,000	9,000
	89,000	80,000	
Belfast Ltd			
Share capital	40,000	40,000	–
Retained earnings	16,000	16,000	–
	56,000	56,000	

(3) **Goodwill**

	Shannon Ltd	**Belfast Ltd**
	£	**£**
Consideration transferred	50,000	45,000
Non-controlling interest at acquisition ((80,000 × 20%/56,000 × 25%)	16,000	14,000
	66,000	59,000
Net assets at acquisition		
Shannon Ltd (W2)	(80,000)	

Belfast Ltd (W2)		(56,000)
(Gain on a bargain purchase)/goodwill	(14,000)	3,000
Recognised in profit or loss (impairment) to date	14,000	(300)
	nil	2,700

(4) **Non-controlling interest at year end**

	£	£
Shannon Ltd		
NCI at acquisition (W3)	16,000	
Share of post-acquisition reserves ((W2) 9,000 × 20%)	1,800	
		17,800
Belfast Ltd		
NCI at acquisition (W3)	14,000	
Share of post-acquisition reserves ((W2) nil × 25%)	–	
		14,000
		31,800

(5) **Retained earnings**

	£
Dublin Ltd	60,000
Shannon Ltd (80% × 9,000 (W2))	7,200
Belfast Ltd (75% × nil (W2))	–
Less goodwill impairment to date (W3)	(300)
Add gain on a bargain purchase (W3)	14,000
	80,900

(6) **PURP**

£12,000 × 20/120 × 50% = £1,000		
	£	£
DR Retained earnings (Shannon)	1,000	
CR Group inventory (current assets)		1,000

14 Close Ltd

14.1

Consolidated statement of financial position as at 31 December 20X9

	£	£
ASSETS		

	£	£
Non-current assets		
Property, plant and equipment (80,000 + 58,200)		138,200
Intangibles (W3)		61,000
		199,200
Current assets		
Inventories (18,000 + 12,000 – 800 PURP (W2))	29,200	
Trade and other receivables (62,700 + 21,100)	83,800	
Investments	2,500	
Cash and cash equivalents (10,000 + 3,000 + 500)	13,500	
		129,000
Total assets		328,200
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Ordinary share capital		120,000
Share premium account		18,000
Revaluation surplus		23,000
Retained earnings (W5)		57,160
		218,160
Non-controlling interest (W4)		6,040
Total equity		224,200
Current liabilities		
Acquired contingent liability		58,000
Trade and other payables (35,000 + 11,000)		46,000
Total equity and liabilities		328,200

14.2 **Adjustments**

14.3 When group companies have been trading with each other two separate adjustments may be required in the consolidated statement of financial position. When group companies have been trading with each other two separate adjustments may be required in the consolidated statement of financial position.

(1) Elimination of unrealised profits

If one company holds inventories at the year end which have been acquired from another group company, this may include a profit element that is unrealised from a group perspective.

Here Steele Ltd has sold goods to Close Ltd at cost plus 25%. The mark-up of 25% will only become realised when the goods are sold to a third party. Therefore if any intra-group inventory is still held at the year end, the profit thereon should be eliminated from the consolidated accounts.

This will require an adjustment of £800 (4,000 × 25/125) which is always made against the selling company's retained earnings, ie

	DR	CR
	£	£
Steele Ltd's retained earnings (W2)	800	
Consolidated inventory		800

As well as eliminating the unrealised profit, this reduces inventory back to its original cost to the group.

(2) Eliminate intra-group balances

As group companies are effectively treated as one entity, any intra-group balances must be eliminated on consolidation. Here, intra-group current accounts have arisen as a result of the intra-group trading and these must be cancelled out. Before this can be done the current accounts must be brought into agreement by adjusting the accounts of the 'receiving' company (here Steele Ltd) for the cheque in-transit, ie

	DR	CR
	£	£
Cash	500	
Current account		500

This will reduce the current account receivable to £2,700, which means that it now agrees with the payable balance shown in the accounts of Close Ltd.

	DR	CR
	£	£
Current account in Close Ltd	2,700	
Current account in Steele Ltd		2,700

WORKINGS

(1) **Group structure**

(2) **Net assets of Steele Ltd**

	Year end		**Acquisition date**	**Post-acquisition**
	£	£	£	£
Share capital		60,000	60,00	–
Revaluation surplus		16,000	16,000	–
Retained earnings				
Per question	13,000			
Less: PURP (4,000 × 25/125)	(800)			
		12,200	8,000	4,200
Contingent liability		(58,000)	(58,000)	

		30,200	26,000	

(3) **Goodwill**

	£
Consideration transferred	84,000
Non-controlling interest at acquisition (26,000 × 20% (W2))	5,200
	89,200
Less net assets at acquisition (W2)	(26,000)
	63,200
Impairment to date (500 + 1,700)	(2,200)
Balance c/f	61,000

(4) **Non-controlling interest at year end**

	£
Steele Ltd – NCI at acquisition (20% × 26,000 (W2))	5,200
Share of post-acquisition reserves (20% × 4,200 (W2))	840
	6,040

(5) **Retained earnings**

	£
Close Ltd	56,000
Steele Ltd (80% × 4,200 (W2))	3,360
Less goodwill impairment to date (W3)	(2,200)
	57,160

Appendix

Tax Tables FA2020

Syllabus area: Administration

SUBMISSION DATES

Submission dates for 2020/21 personal self-assessment tax returns

Return filed online	Later of: 31 January 2022 3 months from the date of issue of return
Paper returns	Later of: 31 October 2021 3 months from the date of issue of return

Submission dates for corporation tax returns

Must be filed by 12 months from the end of the period of account.

Submission dates for PAYE information: Real Time Information

Information	**Filing date**
Full Payment Submission (FPS)	On or before the day the employee is paid
P60 (to employees)	31 May following the tax year end
P11D	6 July following the tax year end

PAYMENT DATES

Payment dates for income tax

Payment	**Filing date**
First interim payment (1)	31 January in the tax year
Second interim payment (1)	31 July following the tax year end
Balancing payment	31 January following the tax year end

(1) Interim payments are not required if the tax paid by assessment for the previous year was less than:

£1,000; or

20% of the total tax liability (income tax and Class 4)

Payment dates for capital gains tax

Capital gains tax is payable by 31 January following the tax year end.

Payment dates for corporation tax	
Corporation tax	Nine months and one day after the end of an accounting period
Corporation tax by instalments – large companies	The 14th day of months 7, 10, 13 and 16 counted from the start of a 12-month accounting period
Corporation tax by instalments – very large companies	The 14th day of months 3, 6, 9 and 12 counted from the start of a 12-month accounting period

Payment dates for VAT

	Due date
Electronic payment	7 calendar days after the last day of the month following the end of the return period
Direct debit payment	Collected automatically 3 working days after electronic payment due date

MAIN PENALTY PROVISIONS

PENALTIES FOR INCORRECT RETURNS

The penalties are a percentage of the potential lost revenue

Reason for penalty	Maximum penalty	Minimum penalty with unprompted disclosure	Minimum penalty with prompted disclosure
Careless action	30%	Nil	15%
Deliberate but not concealed action	70%	20%	35%
Deliberate and concealed action	100%	30%	50%

PENALTIES FOR FAILURE TO NOTIFY

Failures to notify chargeability to tax, or liability to register for tax that leads to a loss of tax will result in a penalty. The penalties are a percentage of the potential lost revenue.

Reason for penalty	Maximum penalty	Minimum penalty with unprompted disclosure		Minimum penalty with prompted disclosure	
Deliberate and concealed action	100%		30%		50%
Deliberate but not concealed action	70%		20%		35%
		>12m	<12m	>12m	<12m
Any other case	30%	10%	Nil	20%	10%

COMPANIES: PENALTIES

Offence	Maximum Penalty
Failure to notify chargeability within 12 months of end of accounting period	See above: penalties for failure to notify

Corporation tax: penalties for late filing of a corporation tax return

Offence	Penalty(1)
Late return, up to 3 months late	£100 fixed penalty, or £500 for persistent failure
Return more than 3 months late	£200 fixed penalty, or £1,000 for persistent failure
Return filed more than 18 months but less than 24 months after end of return period	Tax geared penalty of 10% of tax unpaid 18 months after end of return period
Return filed more than 24 months after end of return period	Tax geared penalty of 20% of tax unpaid 18 months after end of return period

(1) The tax geared penalty is charged in addition to the fixed penalty but only one of each type of penalty is charged.

INDIVIDUALS: PENALTIES

Offence	Maximum Penalty
Failure to notify chargeability by 5 October following tax year end	See above: penalties for failure to notify
Late payment of income tax or capital gains tax: (1)	
Unpaid 30 days after payment due date	5% of tax unpaid
Unpaid 6 months after payment due date	Further 5% of tax unpaid
Unpaid 12 months after payment due date	Further 5% of tax unpaid

(1) Late payment penalties do not apply to payments on account.

Income tax and CGT: penalties for late filing of a self-assessment return

Offence	Maximum Penalty
Late return	Immediate £100 fixed penalty
Return more than 3 months late	Daily fixed penalties of up to £10 per day for maximum 90 days
Return more than 6 months but less than 12 months late	Further tax geared penalty of 5% of tax due (minimum £300)
Return 12 months late	Further tax geared penalties apply (minimum £300): 100% if deliberate and concealed(1) 70% if deliberate but not concealed(1) 5% in all other cases

(1) These tax geared penalties are reduced for disclosure as per penalties for incorrect returns.

PAYE: penalties for late returns/ submissions

Number of employees	Monthly penalty
1 to 9	£100
10 to 49	£200
50 to 249	£300
250 or more	£400

If the form is more than three months late, an additional penalty is due of 5% of the tax and NIC that should have been reported.

Additionally, there is a £300 penalty per late P11D return, with an extra £60 per day charged if the delay continues.

PAYE: penalties for late payment

	No of late payments	% of tax unpaid(1)
Penalties for late payment of in-year PAYE depend on the number of defaults in the tax year	1st	nil
	2nd, 3rd & 4th	1%
	5th, 6th & 7th	2%
	8th, 9th & 10th	3%
	11th or more	4%
Where a penalty has been imposed and the tax remains unpaid at 6 months		5%(2)
Where a penalty has been imposed and the tax		5%(2)

remains unpaid at 12 months

(1) The percentage penalty is applied to the total amount that is late in the relevant tax month.

(2) The 6 month and the further 12 month penalties are in addition to the initial penalty for late payment.

VAT: penalties

Offence	Maximum Penalty
Failure to notify liability for registration or change in nature of supplies by person exempted from registration	See above: penalties for failure to notify

VAT: late payment or late filing – default surcharge

Default involving late payment of VAT in the surcharge period(1)	Surcharge as a percentage of the VAT outstanding at the due date
First	2%(2)
Second	5%(2)
Third	10%(3)
Fourth	15%(3)

(1) Default if late payment of VAT or filing of VAT return and surcharge liability notice issued, but default surcharge only applies on late payment.

(2) No surcharge if it would be less than £400.

(3) Minimum £30 payable.

VAT errors

An error made on a VAT return can be corrected on the next return provided it was not deliberate and does not exceed the greater of:

- £10,000 (net under-declaration minus over-declaration); or
- 1% x net VAT turnover for return period (maximum £50,000)

Alternatively, a 'small' error which is not deliberate may be corrected via the submission of form VAT652. Errors which are not 'small' or errors which are deliberate should be notified to HMRC on form VAT652.

RECORD KEEPING PENALTY

Offence	Maximum Penalty
Failure to keep and retain tax records	£3,000 per tax year / accounting period

INCOME TAX RATES: 2020/21

	Rate	Taxable income band
Main rates		
Basic rate	20%	£1 – £37,500
Higher rate	40%	£37,501 – £150,000
Additional rate	45%	Over £150,000
Savings rates		
Starting rate for savings	0%	£1 - £5,000
Savings income nil rate	0%	First £1,000 or £500
Savings basic rate	20%	Otherwise chargeable at basic rate

	Rate	Taxable income band
Savings higher rate	40%	Otherwise chargeable at higher rate
Savings additional rate	45%	Otherwise chargeable at additional rate
Dividends rates		
Dividend nil rate	0%	First £2,000
Dividend ordinary rate	7.5%	Otherwise chargeable at basic rate
Dividend upper rate	32.5%	Otherwise chargeable at higher rate
Dividend additional rate	38.1%	Otherwise chargeable at additional rate
Default rates		
Default basic rate	20%	
Default higher rate	40%	
Default additional rate	45%	

INCOME TAX RELIEFS	2020/21
Personal allowance	£12,500

CGT RATES

	2020/21
Gains falling within the remaining basic rate band	10%
Gains exceeding the basic rate band	20%

CORPORATION TAX RATES

	FY 2020
Tax rate	19%
Augmented profits limit for corporation tax payment dates – large companies	£1,500,000
Augmented profits limit for corporation tax payment dates – very large companies	£20,000,000

NATIONAL INSURANCE CONTRIBUTIONS

	2020/21		
NIC CLASS 1	Annual	Monthly	Weekly
Primary threshold (PT)	£9,500	£792	£183
Secondary threshold (ST)	£8,788	£732	£169
Upper earnings limit (UEL)	£50,000	£4,167	£962
Apprentice upper secondary threshold (AUST) for under 25s	£50,000	£4,167	£962
Upper secondary threshold (UST) for under 21s	£50,000	£4,167	£962

		2020/21		
NIC CLASS 1		**Annual**	**Monthly**	**Weekly**
Employment allowance (per year, per employer)	£4,000			
Class 1 Primary contributions on earnings between PT & UEL	12%			
Class 1 Primary contributions on earnings above UEL	2%			
Class 1 Secondary contributions on earnings above ST where employee aged 21 or over and not an apprentice under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & AUST for apprentices under the age of 25	0%			
Class 1 Secondary contributions on earnings above AUST for apprentices under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & UST for employees under the age of 21	0%			
Class 1 Secondary contributions on earnings above UST for employees under the age of 21	13.8%			
Class 1A contributions	13.8%			

	2020/21
NIC CLASS 2	
Normal rate	£3.05 pw
Small profits threshold	£6,475 pa
NIC CLASS 4	
Annual lower profits limit (LPL)	£9,500
Annual upper profits limit (UPL)	£50,000
Percentage rate between LPL & UPL	9%
Percentage rate above UPL	2%

VAT	
Standard rate of VAT	20%
Reduced rate of VAT	5%

Syllabus Area: Income Tax & NIC

INCOME TAX RATES: 2020/21	**Rate**	**Taxable income band**
Main rates		
Basic rate	20%	£1 – £37,500
Higher rate	40%	£37,501 – £150,000
Additional rate	45%	Over £150,000
Savings rates		

INCOME TAX RATES: 2020/21	Rate	Taxable income band
Starting rate for savings	0%	£1 - £5,000
Savings income nil rate	0%	First £1,000 or £500
Savings basic rate	20%	Otherwise chargeable at basic rate
Savings higher rate	40%	Otherwise chargeable at higher rate
Savings additional rate	45%	Otherwise chargeable at additional rate
Dividends rates		
Dividend nil rate	0%	First £2,000
Dividend ordinary rate	7.5%	Otherwise chargeable at basic rate
Dividend upper rate	32.5%	Otherwise chargeable at higher rate
Dividend additional rate	38.1%	Otherwise chargeable at additional rate
Default rates		
Default basic rate	20%	
Default higher rate	40%	
Default additional rate	45%	

INCOME TAX RELIEFS	2020/21
Personal allowance(1)	£12,500
Marriage allowance(2)	£1,250

(1) The personal allowance of any individual with adjusted net income above £100,000 is reduced by £1 for every £2 of adjusted net income above the £100,000 limit.

(2) A spouse or civil partner who is a basic rate taxpayer or who has income of less than the personal allowance is allowed to transfer £1,250 of their personal allowance (ie 10% rounded up to the next £10) to their spouse/civil partner provided the recipient spouse is a basic rate taxpayer.

CAPITAL ALLOWANCES

First year allowances available

100% on new and unused zero emissions goods vehicles

100% on new and unused low emission cars ie electrically propelled or with CO_2 emissions of not more than 50 g/km

100% on electric vehicle charging points

Annual investment allowance

£200,000 pa of expenditure incurred by any business on certain plant and machinery from 1 January 2021.

Writing down allowances

18% pa in the main pool

COMPANY VANS, CARS AND FUEL

Van scale charge

No charge applies if there is insignificant private use

£2,792 if van has zero CO_2 emissions and £3,490 if it has CO_2 emissions

Additional £666 if private fuel provided for the van

Company cars – cash equivalent	
Zero emissions cars	0% of list price

Company cars – cash equivalent

Hybrid cars with emissions 1-50g/km	2% of list price for cars with a battery range of >130 miles
	5% of list price for cars with a battery range of 70-129 miles
	8% of list price for cars with a battery range of 40-69 miles
	12% of list price for cars with a battery range of 30-39 miles
	14% of list price for cars with a battery range of <30 miles
Other cars	15% of list price for cars emitting 51-54g/km
	16% of list price for cars emitting 55-59g/km
	17% of list price for cars emitting 60-64g/km
	18% of list price for cars emitting 65-69g/km
	19% of list price for cars emitting 70-74g/km
	20% of list price for cars emitting 75-79g/km
	Increased by 1% per 5g/km over the 75g/km relevant threshold

Relevant % is reduced by 2% for cars first registered from 6 April 2020

Capped at 37% of list price (ie emissions of 160g/km or more for cars first registered before 6 April 2020 and 170g/km for cars first registered from 6 April 2020)

Diesel cars that meet the Real Driving Emissions Step 2 (RDE2) standard are treated as above, all other diesel cars have a 4% supplement added to the relevant percentage (subject to 37% cap)

Private fuel provided for company car

£24,500 x company car %

PAYE CODES

L	tax code with personal allowance
M	tax code with personal allowance plus claiming marriage allowance
N	tax code with personal allowance less surrendered marriage allowance
S	income taxed at Scottish rate of income tax
C	income taxed at Welsh rate of income tax
K	total allowances are less than total deductions
T	tax code includes other calculations to work the personal allowance, for example it has been reduced because estimated annual income is more than £100,000

NATIONAL INSURANCE CONTRIBUTIONS

	2020/21		
NIC CLASS 1 CONTRIBUTIONS	**Annual**	**Monthly**	**Weekly**
Primary threshold (PT)	£9,500	£792	£183
Secondary threshold (ST)	£8,788	£732	£169
Upper earnings limit (UEL)	£50,000	£4,167	£962

NIC CLASS 1 CONTRIBUTIONS		2020/21 Annual	Monthly	Weekly
Apprentice upper secondary threshold (AUST) for under 25s		£50,000	£4,167	£962
Upper secondary threshold (UST) for under 21s		£50,000	£4,167	£962
Employment allowance (per year, per employer)	£4,000			
Class 1 Primary contributions on earnings between PT & UEL	12%			
Class 1 Primary contributions on earnings above UEL	2%			
Class 1 Secondary contributions on earnings above ST where employee aged 21 or over and not an apprentice under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & AUST for apprentices under the age of 25	0%			
Class 1 Secondary contributions on earnings above AUST for apprentices under the age of 25	13.8%			
Class 1 Secondary contributions on earnings between ST & UST for employees under the age of 21	0%			
Class 1 Secondary contributions on earnings above UST for employees under the age of 21	13.8%			
Class 1A contributions	13.8%			

	2020/21
NIC CLASS 2 CONTRIBUTIONS	
Normal rate	£3.05 pw
Small profits threshold	£6,475 pa
NIC CLASS 4 CONTRIBUTIONS	
Annual lower profits limit (LPL)	£9,500
Annual upper profits limit (UPL)	£50,000
Percentage rate between LPL & UPL	9%
Percentage rate above UPL	2%

Syllabus area: Capital Gains

	2020/21
Annual exempt amount	£12,300
Gains falling within the remaining basic rate band	10%
Gains exceeding the basic rate band	20%
Basic rate band	£1 – £37,500

Syllabus area: Corporation tax

	FY 2020
Tax rate	19%
Augmented profits limit for corporation tax payment dates – large companies	£1,500,000
Augmented profits limit for corporation tax payment dates – very large companies	£20,000,000

CAPITAL ALLOWANCES

First year allowances available

100% on new and unused zero emissions goods vehicles

100% on new and unused low emission cars ie electrically propelled or with CO_2 emissions of not more than 50 g/km

100% on electric vehicle charging points

Annual investment allowance

£200,000 pa of expenditure incurred by any business on certain plant and machinery from 1 January 2021.

Writing down allowances

18% pa in the main pool

PAYMENT DATES

Payment dates for corporation tax	
Corporation tax	Nine months and one day after the end of an accounting period
Corporation tax by instalments – large companies	The 14th day of months 7, 10, 13 and 16 counted from the start of a 12-month accounting period
Corporation tax by instalments – very large companies	The 14th day of months 3, 6, 9 and 12 counted from the start of a 12-month accounting period

Syllabus area: Value Added Tax

VAT		
Standard rate		20%
Reduced rate		5%
Annual registration limit	From 1 April 2017	£85,000
Deregistration limit	From 1 April 2017	£83,000
VAT fraction (standard rated)		1/6

Cash accounting	**£**
Turnover threshold to join scheme	1,350,000
Turnover threshold to leave scheme	1,600,000
Annual accounting	
Turnover threshold to join scheme	1,350,000
Turnover threshold to leave scheme	1,600,000

Flat rate scheme	
Annual taxable turnover limit (excluding VAT) to join scheme	150,000
Annual total income (including VAT) to leave scheme	230,000

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